

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-70885; File No. SR-TOPAZ-2013-11)

November 15, 2013

Self-Regulatory Organizations; Topaz Exchange, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Address the Treatment of Certain Stop Orders During a Limit State or Straddle State

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 November 7, 2013, the Topaz Exchange, LLC (d/b/a ISE Gemini) (the "Exchange" or "Topaz") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of the Substance of the Proposed Rule Change

The Exchange proposes to amend its rules to address how certain stop orders are handled during a Limit State or Straddle State.

The text of the proposed rule change is available on the Exchange's Internet website at <http://www.ise.com>, at the principal office of the Exchange, 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

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

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

in Item IV below. The self-regulatory organization 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 purpose of this proposed rule change is to amend Exchange rules to address how stop orders are handled during a Limit State<sup>3</sup> or Straddle State.<sup>4</sup> On May 31, 2012, the Commission approved the Plan to Address Extraordinary Market Volatility (the “Plan”),<sup>5</sup> which establishes procedures to address extraordinary volatility in NMS Stocks. The procedures provide for market-wide limit up-limit down requirements that prevent trades in individual NMS Stocks from occurring outside of specified Price Bands. These limit up-limit down requirements are coupled with Trading Pauses to accommodate more fundamental price moves. The Plan procedures are designed, among other things, to protect investors and promote fair and orderly markets.<sup>6</sup> The Plan has been implemented, as a one year pilot program, in two phases.<sup>7</sup> Phase I of the Plan became effective on April 18, 2013 and applies to Tier I NMS Stocks per Appendix A of the Plan, with Phase II, which would apply to all NMS Stocks, scheduled to become effective six months later.

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<sup>3</sup> Limit State means the condition when the national best bid or national best offer for an underlying security equals an applicable price band, as determined by the primary listing exchange for the underlying security. See Topaz Rule 703A(a)(2).

<sup>4</sup> Straddle State means the condition when the national best bid or national best offer for an underlying security is non-executable, as determined by the primary listing exchange for the underlying security, but the security is not in a Limit State. See Topaz Rule 703A(a)(3).

<sup>5</sup> See Securities Exchange Act Release No. 67091 (May 31, 2012), 77 F.R. 33498 (June 6, 2012) (File No. 4-631) (“Plan Approval Order”).

<sup>6</sup> Id.

<sup>7</sup> Id.

Topaz is not a participant in the Plan because it does not trade NMS Stocks. However, Topaz trades options contracts overlying NMS Stocks. Because options pricing models are highly dependent on the price of the underlying security and the ability of options traders to effect hedging transactions in the underlying security, the implementation of the Plan impacts the trading of options classes traded on the Exchange.

When the national best bid (offer) for a security underlying an options class is non-executable, the ability for options market participants to purchase (sell) shares of the underlying security and the price at which they may be able to purchase (sell) shares becomes uncertain, as there is a lack of transparency regarding the availability of liquidity for the security. This uncertainty is factored into the options pricing models of market professionals, such as options market makers, which then results in wider spreads and less liquidity at the best bid and offer for the options class. To address trading during limit up-limit down states, the Exchange has rules that govern the handling of market orders and stop orders.<sup>8</sup> Specifically, the Exchange currently automatically rejects all incoming orders that do not contain a limit price to protect them from being executed at prices that may be vastly inferior to the prices available immediately prior to or following a Limit State or Straddle State.<sup>9</sup> Such un-priced orders include market orders and stop orders, which become market orders when the stop price is elected.<sup>10</sup> The Exchange also currently cancels any unexecuted market orders and unexecuted stop orders.

After discussions with, and at the request of members, the Exchange now proposes to amend the treatment of unexecuted stop orders. Specifically, the Exchange proposes to hold, rather than cancel, all unexecuted stop orders pending in the trading system until the end of a

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<sup>8</sup> See Topaz Rule 703A(b)

<sup>9</sup> See Topaz Rules 703A(b)(1) and (2).

<sup>10</sup> See Topaz Rule 715(e).

Limit State or Straddle State, at which point the order will become eligible to be elected if the market for the particular option contract has reached the specified contract price. The Exchange believes that it is unduly burdensome for members to have stop orders cancelled back to them without their affirmatively choosing to do so, particularly when these orders have not become eligible to be elected and therefore are not at risk of being executed at inferior prices. The Exchange further believes it is appropriate, in the interests of promoting fair and orderly markets, to hold unexecuted stop orders rather than cancel them, until the end of a Limit State or Straddle State. The Exchange believes that when investors enter a stop order, they have an expectation that the stop order will be traded at the elected price once a Limit State or Straddle State has ended, and that the order will not be cancelled back to them. Investors send stop orders because they do not want to continuously monitor them and expect that the order will execute once the stop price has been reached. The Exchange believes it is onerous for investors to have these orders cancelled back to them when they expect these orders to trade at their stopped price. The Exchange is not proposing any change to how unexecuted market orders are treated and, per Rule 703A(b)(1), these orders will continue to be canceled upon the initiation of a Limit State or Straddle State in the underlying security. The Exchange believes that holding unexecuted market orders until the underlying security comes out of a Limit State or Straddle State could result in these orders being executed at prices drastically different from the time when these orders were first sent to the Exchange for execution. As noted above, orders that do not contain a limit price are at risk of being executed at inferior prices if the Exchange were to hold such orders in the system until the underlying security comes out of a Limit State or Straddle State. Canceling such orders therefore provides investors the opportunity to submit their orders for execution at their expected price.

While the proposed treatment of unexecuted stop orders is a departure from how these orders are currently addressed, the Exchange believes this rule change will promote fair and orderly markets as investors will have greater certainty that these orders will be executed once they become eligible rather than be cancelled. The proposed rule change is also consistent with how such orders are treated on other exchanges.<sup>11</sup>

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Securities Exchange Act of 1934 (the “Act”)<sup>12</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>13</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest.

As discussed above, when an underlying security enters a Limit State or Straddle State, the best bid and offer in the options class is likely to widen considerably, and the liquidity available at those prices may be greatly reduced. Given that a Limit State or a Straddle State may be resolved very quickly, the Exchange believes holding unexecuted stop orders in the trading system until the end of a Limit State or a Straddle State, rather than canceling them, will provide market participants a greater opportunity to have their orders executed when the market for the particular option contract reaches its specified price.

### B. Self-Regulatory Organization’s Statement on Burden on Competition

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<sup>11</sup> See Chicago Board Options Exchange, Inc. (“CBOE”) Rule 6.53, Interpretation and Policies .01(C).

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

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

The Exchange does not believe that the proposal 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 rule change will not impose any burden on intramarket competition because it will apply to all market makers equally. The Exchange does not believe the proposed rule change will impose any burden on intermarket competition as the proposed change is made for the protection of investors.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The Exchange has not solicited, and does not intend to solicit, comments on this proposed rule change. The Exchange has not received any unsolicited written comments from members or other interested parties.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The Exchange believes that the foregoing proposed rule change may take effect upon filing with the Commission pursuant to Section 19(b)(3)(A)<sup>14</sup> of the Act and Rule 19b-4(f)(6) thereunder<sup>15</sup> because the foregoing proposed rule change does not (i) significantly affect the protection of investors or the public interest, (ii) impose any significant burden on competition, and (iii) become operative for 30 days after its filing date, or such shorter time as the Commission may designate.

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is: (i) necessary or appropriate in the public interest; (ii) for the protection of investors; or (iii) otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the

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<sup>14</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>15</sup> 17 CFR 240.19b-4(f)(6).

Commission shall institute proceedings to determine whether the proposed rule 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-TOPAZ-2013-11 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-TOPAZ-2013-11. 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 20549-1090, on official business days between the hours of 10:00

a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal offices of Topaz. 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-TOPAZ-2013-11, 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>16</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>16</sup> 17 CFR 200.30-3(a)(12).