

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-64011; File No. SR-C2-2011-008)

March 2, 2011

Self-Regulatory Organizations; C2 Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change to Allow the Listing and Trading of a P.M.-Settled S&P 500 Index Option Product

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 February 28, 2011, C2 Options Exchange, Incorporated (the “Exchange” or “C2”) 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 permit the listing and trading of P.M.-settled S&P 500 Index options on C2. The text of the proposed rule change is available on the Exchange’s website (<http://www.c2exchange.com>), at the Exchange’s Office of the Secretary, and at the Commission.

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 those 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 parts of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of this rule filing is to permit the listing and trading on C2 of Standard & Poor's 500 Index ("S&P 500") options with third-Friday-of-the-month ("Expiration Friday") expiration dates for which the exercise settlement value will be based on the index value derived from the closing prices of component securities ("P.M.-settled").

To effect the above described change, the Exchange is proposing to add new supplemental provision (a) to C2 Chapter 24 to expressly provide that P.M.-settled S&P 500 options may be listed for trading on C2. Existing C2 rules governing the trading of index options would apply to this new product (e.g. trading rules, sales practice rules, margin requirements, and strike price interval requirements).

The S&P 500 is a capitalization-weighted index of 500 stocks from a broad range of industries. The component stocks are weighted according to the total market value of their outstanding shares. The impact of a component's price change is proportional to the issue's total market share value, which is the share price times the number of shares outstanding. These are summed for all 500 stocks and divided by a predetermined base value. The base value for the S&P 500 is adjusted to reflect changes in capitalization resulting from, among other things, mergers, acquisitions, stock rights, and substitutions.

The proposed contract would use a \$100 multiplier, and the minimum trading increment would be \$0.05 for options trading below \$3.00 and \$0.10 for all other series. Strike price intervals would be set no less than 5 points apart. Consistent with existing rules for index

options, the Exchange would allow up to twelve near-term expiration months, as well as LEAPS.³ Expiration processing would occur on Saturday following the Expiration Friday. The product would have European-style exercise, and because it is based on the S&P 500 index, there would be no position limits.⁴

C2 notes that ample precedent exists for P.M. settlement of broad-based index options. For example, OEX (an index option contract based on the Standard & Poor's 100 index) has been P.M.-settled since 1983.⁵ Also, FLEX Options have P.M. settlements on any expiration day (pursuant to a pilot program).⁶ Similarly, CBOE recently established a pilot program that permits P.M.-settled options on broad-based indexes expiring on any Friday of the month, other than the third Friday of the month, as well as the last trading day of the month.⁷ CBOE also trades Quarterly Option Series⁸ that overlie exchange traded funds or indexes, and Quarterly Index Expirations⁹ that are cash-settled options on certain broad-based indexes, both of which expire at the close of business on the last business day of a calendar quarter and are P.M.-settled.

³ Pursuant to CBOE Rule 24.9(b), index LEAPS may expire from 12-60 months from the date of issuance.

⁴ There would be reporting requirements pursuant to Rule 4.13, Reports Related to Position Limits, and Interpretation and Policy .03 to Rule 24.4, Position Limits for Broad-Based Index Options, which sets forth the reporting requirements for certain broad-based indexes that do not have position limits.

⁵ The Exchange notes that there are no futures or options on futures traded on the S&P 100 at this time.

⁶ See Securities Exchange Act Release No. 61439 (January 28, 2010), 75 FR 5831 (February 4, 2010) (SR-CBOE-2009-087) (order approving rule change to establish a pilot program to modify FLEX option exercise settlement values and minimum value sizes). This pilot expires on March 28, 2011.

⁷ See Rule 24.9(e) and Securities Exchange Act Release No. 62911 (September 14, 2010), 75 FR 57539 (September 21, 2010) (SR-CBOE-2009-075).

⁸ See Rules 5.5(e) and 24.9(a)(2)(B).

⁹ See Rule 24.9(c).

CBOE has experience with these special dated options and has not observed any market disruptions resulting from the P.M.-settlement feature of these options.

In addition, the Exchange believes that the reasons supporting the preponderance of A.M.- settlement index options, which date back to the late 1980s/ early 1990s for Non-FLEX Options and revolve around a concern about expiration pressure on stock exchanges (more specifically on specialists) at the close, are no longer relevant in today's market. For one, there are multiple primary listing and unlisted trading privilege (UTP) markets for the stocks underlying the index, and trading is widely dispersed among several stock exchanges and alternative trading systems. Many of these markets use closing cross procedures and employ closing order types to facilitate orderly closings.¹⁰ Moreover, today stock order flow is predominantly electronic and the ability to smooth out openings and closings is greatly enhanced and market-on-close procedures work just as well as opening procedures. Thus, the Exchange does not believe that any market disruptions will be encountered with the introduction of P.M.-settled S&P 500 index options.

The Exchange also notes that P.M.-settled options predominate in the OTC market, and C2 is not aware of any adverse effects in the stock market attributable to the P.M.-settlement feature. C2 is merely proposing to offer a P.M.-settled product in an exchange environment which offers the benefit of added transparency, price discovery, and stability.

In response to any potential concerns that disruptive trading conduct could occur as a result of the concurrent listing and trading of two index option products based on the same index but for which different settlement methodologies exist (i.e., one is A.M.-settled and one is P.M.-settled), the Exchange notes that for roughly five years (1987 to 1992) CBOE listed and traded

¹⁰ For example, see Nasdaq Rule 4754 (Nasdaq Closing Cross).

an A.M.-settled S&P 500 index option called NSX at the same time it listed and traded a P.M.-settled S&P 500 index option called SPX and CBOE did not observe any market disruptions as a result of offering both products.

As proposed, the proposal would become effective on a pilot program basis for a period of fourteen months. If the Exchange were to propose an extension of the program or should the Exchange propose to make the program permanent, then the Exchange would submit a filing proposing such amendments to the program. The Exchange notes that any positions established under the pilot would not be impacted by the expiration of the pilot. For example, a position in a P.M.-settled series that expires beyond the conclusion of the pilot period could be established during the 14-month pilot. If the pilot program were not extended, then the position could continue to exist. However, the Exchange notes that any further trading in the series would be restricted to transactions where at least one side of the trade is a closing transaction.

As part of the pilot program, the Exchange would also submit a pilot program report to the Commission at least two months prior to the expiration date of the program (the “annual report”). As described below, the annual report would contain an analysis of volume, open interest and trading patterns. The analysis would examine trading in the proposed option product as well as trading in the securities that comprise the S&P 500 index. In addition, for series that exceed certain minimum open interest parameters, the annual report would provide analysis of index price volatility and share trading activity. The annual report would be provided to the Commission on a confidential basis.

The annual report would contain the following volume and open interest data:

- (1) monthly volume aggregated for all trades;
- (2) monthly volume aggregated by expiration date;

- (3) monthly volume for each individual series;
- (4) month-end open interest aggregated for all series;
- (5) month-end open interest for all series aggregated by expiration date; and
- (6) month-end open interest for each individual series.

In addition to the annual report, the Exchange would provide the Commission with interim reports of the information listed in Items (1) through (6) above periodically as required by the Commission while the pilot is in effect. These interim reports would also be provided on a confidential basis. The annual report would also contain the information noted in Items (1) through (6) above for Expiration Friday, A.M.-settled S&P 500 index options traded on CBOE.

In addition, the annual report would contain the following analysis of trading patterns in Expiration Friday, P.M.-settled S&P 500 Index option series in the pilot:

- (1) a time series analysis of open interest; and
- (2) an analysis of the distribution of trade sizes.

Also, for series that exceed certain minimum parameters, the annual report would contain the following analysis related to index price changes and underlying share trading volume at the close on Expiration Fridays:

- (1) a comparison of index price changes at the close of trading on a given Expiration Friday with comparable price changes from a control sample. The data would include a calculation of percentage price changes for various time intervals and compare that information to the respective control sample. Raw percentage price change data as well as percentage price change data normalized for prevailing market volatility, as measured by the CBOE Volatility Index (VIX), would be provided; and

(2) a calculation of share volume for a sample set of the component securities representing an upper limit on share trading that could be attributable to expiring in-the-money series. The data would include a comparison of the calculated share volume for securities in the sample set to the average daily trading volumes of those securities over a sample period.

The minimum open interest parameters, control sample, time intervals, method for randomly selecting the component securities, and sample periods would be determined by the Exchange and the Commission.

The Exchange represents that it has sufficient capacity to handle additional traffic associated with this new listing, and that it has in place adequate surveillance procedures to monitor trading in these options thereby helping to ensure the maintenance of a fair and orderly market.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Act¹¹ and the rules and regulations thereunder and, in particular, the requirements of Section 6(b) of the Act.¹² Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)¹³ requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to remove impediments to and to perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest. The Exchange believes that the introduction of P.M. settlement for the subject index option in the manner proposed does not raise any meaningful regulatory concerns. Further, the Exchange

¹¹ 15 U.S.C. 78a et seq.

¹² 15 U.S.C. 78f(b).

¹³ 15 U.S.C. 78f(b)(5).

believes that the proposal will not adversely impact fair and orderly markets on expiration Fridays for the underlying stocks comprising the S&P 500 index. As discussed in section (a) of Item 2 of this filing (the purpose section), the handling of orders at the close on the stock markets has matured considerably since concerns were initially raised in the late 1980s. Additionally, the proposed rule change would provide permit holders and investors with additional opportunities to trade S&P 500 options with a P.M. settlement feature in an exchange environment and subject to transparent exchange-based rules, and that investors would also benefit from the opportunity to trade in association with this product on Expiration Fridays thereby removing impediments to a free and open market consistent with the Act.

B. Self-Regulatory Organization's Statement on Burden on Competition

C2 does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

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

No written comments were solicited or received with respect to 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 (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization 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 Number SR-C2-2011-008 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 Number SR-C2-2011-008. 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 also will be available for inspection and copying at the principal office of C2. 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-C2-2011-008 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

Cathy H. Ahn
Deputy Secretary

¹⁴ 17 CFR 200.30-3(a)(12).