

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-66210; File No. SR-C2-2012-003)

January 20, 2012

Self-Regulatory Organizations; C2 Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Related to Complex Order Price Check Parameter Features

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on January 9, 2012, the C2 Options Exchange, Incorporated (“Exchange” or “C2”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Exchange has designated the proposal as a “non-controversial” proposed rule change pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6) thereunder.⁴ 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 is proposing to amend its complex order processing rules to update existing price check protection features and include some additional ones. The text of the proposed rule change is available on the Exchange’s website (<http://www.c2exchange.com/Legal/RuleFilings.aspx>), at the Exchange’s Office of the Secretary and at the Commission.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

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 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 Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange has in place various price check parameter features that are designed to prevent incoming orders from automatically executing at potentially erroneous prices. These price check parameter features are designed to help maintain a fair and orderly market. The Exchange is proposing to amend its complex order processing rules under Rule 6.13, Complex Order Execution, to update existing price check protection features to provide additional clarity on the operation of the functionality and to include some additional features. The Exchange believes the below-described price check parameter revisions will enhance the existing functionality and assist with the maintenance of fair and orderly markets by helping to mitigate the potential risks associated with an order drilling through multiple price points (thereby resulting in executions at prices that are extreme and potentially erroneous) and complex orders trading at prices that are inconsistent with particular complex order strategies (thereby resulting in executions at prices that are extreme and potentially erroneous).

First, the Exchange is proposing to include descriptive headings in the rule text for each of the existing price check parameters. The Exchange is also proposing to break the description of the existing same expiration strategy price check parameters into two separate paragraphs

instead of a single paragraph. We believe these changes will make it easier for users to read and understand the operation of these price protection features. These changes are simply non-substantive formatting changes and do not impact the operation of the various features.

Second, the market width parameter under Rule 6.13.04(a) currently provides that the complex order book (“COB”) will not automatically execute eligible complex orders that are market orders if the width between the Exchange’s best bid and best offer (“BBO”) are not within an acceptable price range. In addition, the rule text currently provides that such market complex orders will be cancelled.

The Exchange is proposing to revise this provision to provide that the Exchange may determine to apply these price check parameters to market orders and/or marketable limit orders. However, whereas market orders that are subject to this price protection feature are cancelled, marketable limit orders would be held in the system. Any such orders held in the system would not be eligible to automatically execute until after the market width parameter condition is resolved. In addition, while being held in the system, such orders would be displayed in the COB as applicable. This functionality for marketable limit order is currently in use but not expressly covered in the rules. The Exchange believes that extending the same price check logic to not automatically execute such marketable limit orders but to continue to hold such orders in the system is reasonable and appropriate because, as with market orders, this feature should help to prevent executions of such limit orders at extreme and potentially erroneous prices. In contrast to market orders, marketable limit orders are able to be held in the system because they have a price associated with them. The Exchange also notes that applying market width price check logic to market orders and/or marketable limit orders is consistent with other existing price

check parameters that apply to both market orders and marketable limit complex orders.⁵ In addition, the Exchange is proposing to correct a typographical error by changing the minimum acceptable price range specified in the rule text for orders in option series where the bid is less than \$2 from \$0.37 to \$0.375.⁶

Third, the debit-to-credit (credit-to-debit) parameters under Rule 6.13.04(b) currently provide that (i) a market order that would be executed at a net credit price after receiving a partial execution at a net debit price would not be automatically executed (the “debit-to-credit” parameter), and (ii) a market order that would be executed at a net debit price after receiving a partial execution at a net credit price would not be automatically executed (the “credit-to-debit” parameter). The Exchange is proposing to eliminate the debit-to-credit parameter because it not possible for such a scenario to occur and therefore the parameter is unnecessary. (Because orders are executed at the best available price and then the next best price, a market order would never execute at a net debit price then at a net credit price.)

Fourth, the Exchange is proposing to change the existing same expiration strategy price check parameters to distinguish between its application to limit orders and to market orders. The Exchange is also proposing to eliminate a provision that would make this price check parameter feature available to ratio orders should the Exchange determine to do so. As the term implies, the “same expiration strategy” price protection parameters apply to certain complex order

⁵ See, e.g., Rule 6.17, Price Check Parameters (which provides, among other things, that the Exchange will not automatically execute eligible orders that are marketable if the width between the national best bid and offer is not within an acceptable price range (as determined by the Exchange on a series by series basis for market orders and/or marketable limit orders and announced to Trading Permit Holders via Regulatory Circular).

⁶ The \$0.375 amount is same as the acceptable price range parameters set forth in Rule 6.17.

strategies where all the option series have the same expiration.⁷ The functionality is designed to detect scenarios where (i) a limit order is entered at a net credit price when it clearly should have been entered at a net debit price (or vice versa) and (ii) a market order would be executed at a net debit price when it clearly should be executed at a net credit price (but not vice versa).⁸

Currently the rule text provides that, if the conditions for this price check parameter exist when a complex order is routed to the COB, then the order will be rejected. The rule text also currently provides that, to the extent the parameters are triggered once an order is resting in COB or after an incoming order receives a partial execution, such a complex order will be cancelled. The provision does not distinguish between limit orders and market orders. The Exchange is proposing to amend the text to separately describe how the two categories of orders are processed.

With respect to limit orders, proposed changes to the text provide that incoming limit orders will be rejected under this parameter only if the conditions exist when the order is first routed to COB. The provisions about resting orders and partial executions are not applicable to limit orders because incoming limit orders that are priced at a net price that meets the conditions are rejected outright upon routing to COB and never get to the point where they are resting or partially executed. With respect to market orders, proposed changes to the text provide that, to the extent the parameters are triggered when an incoming market order is routed to COB or after

⁷ See Rule 6.13.04(c).

⁸ A same expiration strategy market order that would result in an execution at a net credit price (i.e., the net sale proceeds from the series being sold are more than the net purchase cost from the series being bought) but that would normally execute at a net debit price (i.e., the net sale proceeds from the series being sold are less than the net purchase cost from the series being bought) would be a favorable execution for the market order and would not trigger this price check parameter. In making the changes to the rule text, the Exchange is correcting a typographical error, which correction clarifies that the same expiration strategy parameter does not apply to market orders that would execute at a net credit.

an incoming market order is subject to a complex order RFR auction (“COA”), any part of the market order that may be executed within an acceptable price range will be executed automatically and the part of the order that would execute at a net debit price will be cancelled. (A market order would never rest in COB, so that provision will be removed from the rule text.)

The following examples illustrate this price check parameter:

Example 1: Assume a complex order to buy 50 Jan 45 XYZ calls and sell 50 Jan 50 XYZ calls is entered with a limit that is a net credit price (i.e., the net sale proceeds from the Jan 50 calls are larger than the net purchase cost from the Jan 45 calls). Such an order would appear to be erroneously priced as a net credit – it should instead be a net debit - because normally a person would expect that the Jan 50 calls would not cost more than the Jan 45 calls. As a result, upon routing to COB, such a limit order would be rejected.

Example 2: Assume a butterfly spread to buy 50 Jan 45 XYZ calls, sell 100 Jan 50 XYZ calls and buy 50 Jan 55 XYZ calls is entered at a net credit price (i.e., the net sale proceeds from the Jan 50 calls are more than the net purchase cost from the Jan 45 and 55 calls). Such an order would appear to be erroneously priced as a net credit – it should instead be a net debit – because normally a person would expect that selling the middle 50 strike would result in less than the cost of buying the upper 55 and lower 45 strikes. As a result, upon routing to COB, such a limit order would be rejected.

Example 3: Assume a market order to buy 50 Jan 45 XYZ calls and sell 50 Jan 40 XYZ calls is entered. Also assume that the Jan 45 XYZ calls are quoted \$4.00 - \$4.10 for 10 contracts and the next available offer is \$4.30 for 100 contracts, and that the Jan 40 XYZ calls are quoted \$4.50 - \$4.60 for 10 contracts and the next available bid is \$4.20 for 100 contracts. Under this scenario, the incoming market order would receive an

execution for 10 spreads at a net credit price of \$0.40 each (i.e., the net sale proceeds from the Jan 40 Series are larger than the net purchase cost from the Jan 45 Series). When the series decrement, the net execution price would become a net debit price of \$0.10 each (i.e., the net sale proceeds from the Jan 40 Series are less than the net purchase cost from the Jan 45 Series). Such an execution would appear to be erroneous because normally a person in this scenario would expect to execute the vertical spread at a net credit price. As a result, upon routing to COB, 10 contracts would execute at a net credit price of \$0.40 each and the remaining 40 contracts would be cancelled.

Example 4: Assume a market order to buy 50 Jan 45 XYZ calls and sell 50 Jan 40 XYZ calls is routed to COA. Also assume that at the end of the COA the Jan 45 XYZ calls are quoted \$4.00 - \$4.10 for 10 contracts and the next available offer is \$4.30 for 100 contracts, and that the Jan 40 XYZ calls are quoted \$4.50 - \$4.60 for 10 contracts and the next available bid is \$4.20 for 100 contracts. To the extent the market order can execute at prices within the price check parameter, then that part of the order would execute (i.e., 10 vertical spreads will execute at a net credit price of \$0.40). To the extent that the price check parameters are triggered at the conclusion of COA, then that part of the market order would be cancelled (i.e., 40 vertical spreads will cancel).

As noted above, the Exchange is also proposing to delete a provision in the rule that provides that the Exchange may determine to make the same expiration strategy price check parameters available to applicable ratio orders (as such applicable ratios are determined by the Exchange on a class-by-class basis). The Exchange has not activated this feature for ratio orders

and has no intention to do so at this time. Therefore, the Exchange is proposing to delete this provision from the rule at this time.⁹

Finally, fifth, the Exchange is proposing to codify a price check parameter for orders processed via COA, which is currently in use but not expressly covered in the rules. Specifically, the Exchange may determine on a class-by-class basis (and announce via Regulatory Circular) that COA will not automatically execute a COA-eligible order that is marketable if the execution would be at a price that is not within an acceptable percentage distance from the derived net price of the individual series legs at the start of COA. For purposes of this provision, the “acceptable percentage distance” will be a percentage determined by the Exchange on a class-by-class basis and it shall be not less than 3 percent. The Exchange believes a 3 percent level is reasonable and appropriate because a marketable order that would deviate from the derived net market by that percentage or more may be indicative of an extreme or potentially erroneous price, and a broker would generally want to evaluate the order further before receiving an automatic execution. The Exchange also believes that a 3 percent minimum is reasonable and appropriate in comparison to other price check parameters it currently has available.¹⁰ To the extent the parameters under this provision are triggered, such a complex order will be cancelled.

For example, the Exchange could determine that the acceptable percentage distance is 5%. Assume at the start of COA the individual leg market in Series A is \$1.00 - \$1.20 and in

⁹ In the future, should the Exchange would determine to apply this price check parameter feature to ratio orders, the Exchange would address it through a separate rule change filing.

¹⁰ The “acceptable percentage distance” price check parameter for complex orders is adapted from the “acceptable tick distance” parameter set forth in Rule 6.17, which provides that the acceptable tick distance shall not be less than 2 minimum increment ticks.

series B is \$2.00 - \$2.20 and the derived leg market is \$0.80 (net debit) - \$1.20 (net credit). The acceptable percentage distance would be \$0.04 (5% X \$0.80) for orders to buy Series A and sell series B and \$0.06 (5% X \$1.20) for orders to sell Series A and buy series B. As a result, COA would execute a COA-eligible order at prices ranging from \$0.84 (net debit) - \$1.26 (net credit), but not an order priced at a net debit of \$0.85 or more or a net credit of \$1.27 or more.

2. Statutory Basis

The proposed rule change is consistent with Section 6(b) of the Act¹¹ in general and furthers the objectives of Section 6(b)(5) of the Act¹² in particular in that it should promote just and equitable principles of trade, serve to remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect investors and the public interest. The Exchange believes the complex order price check parameters assist in the automatic execution and processing of orders that are subject to the Exchange's complex order processing. The Exchange also believes these price check parameters assist with the maintenance of fair and orderly markets by helping to mitigate the potential risks associated with complex orders drilling through multiple price points (thereby resulting in executions at prices that are extreme and potentially erroneous) and complex orders trading at prices that are inconsistent with particular complex order strategies (thereby resulting in executions at prices that are extreme and potentially erroneous). In this regard, for example, the Exchange notes that the acceptable percentage distance parameter is designed to mitigate the potential risks of executions at prices that are not within an acceptable percentage distance from the derived net market price of the individual series legs. The Exchange also notes that the extension of the BBO market width logic to include marketable limit orders is designed to help prevent executions of such limit

¹¹ 15 U.S.C. 78f(b).

¹² 15 U.S.C. 78f(b)(5).

orders at extreme and potentially erroneous prices in a manner consistent with the existing logic utilized for market orders. The Exchange also believes that the proposed changes to the rule text will make it easier for users to read and understand the operation of the price check parameters, and will better and more fully describe the operation of the parameters.

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.

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 proposal.

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

Because the foregoing rule 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 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, provided that the self-regulatory organization has given the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change or such shorter time as designated by the Commission, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act¹³ and Rule 19b-4(f)(6) thereunder.¹⁴ 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

¹³ 15 U.S.C. 78s(b)(3)(A).

¹⁴ 17 CFR 240.19b-4(f)(6).

public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-C2-2012-003 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-C2-2012-003. 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 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-C2-2012-003 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.¹⁵

Kevin M. O'Neill
Deputy Secretary

¹⁵ 17 CFR 200.30-3(a)(12).