

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-67671; File No. SR-C2-2012-026)

August 15, 2012

Self-Regulatory Organizations; C2 Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Its Automatic Order Handling Process

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 August 2, 2012, 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 and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to amend its rules regarding its automatic order handling process.

The text of the proposed rule change is available on the Exchange’s website at

<http://www.c2exchange.com/Legal/>, 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 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 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 its rules regarding its automatic order handling process. The proposed rule change adds paragraph (h) to Rule 6.12 to codify how the System³ handles market orders to sell in option series for which the national best bid in the series is zero (“no-bid series”).⁴ If the System receives during the trading day or has resting in the electronic book (the “Book”) after the opening of trading a market order to sell in a no-bid series, it handles the order as follows:

- if the Exchange best offer in that series is less than or equal to \$0.30, then the System will consider, for the remainder of the trading day, the market order as a limit order to sell with a limit price equal to the minimum trading increment applicable to the series and enter the order into the Book behind limit orders to sell at the minimum increment that are already resting in the Book.
- if the Exchange best offer in that series is greater than \$0.30, then the market order will be cancelled.

The Exchange’s Rules are currently silent on how the System handles market orders to sell in no-bid series. The Exchange believes that proposed Rule 6.12(h) will clarify for investors

³ The System is the automated trading system used by the Exchange for the trading of options contracts.

⁴ The Exchange notes that, for singly listed series, the national best bid is equivalent to the Exchange’s best bid and the national best offer is equivalent to the Exchange’s best offer.

how the System handles these orders.⁵ The Exchange believes that the automatic handling of market orders to sell in no-bid series if the Exchange best offer is less than or equal to \$0.30 facilitates the System's automatic handling process. Additionally, the \$0.30 threshold serves as a protection feature for investors in certain situations, such as when a series is no-bid because the last bid traded just prior to the entry of the market order to sell. The purpose of this threshold is to limit the automatic handling of market orders to sell in no-bid series to only those for true zero-bid options, as options in no-bid series with an offer of more than \$0.30 are likely not worthless.

For example, if the System receives a market order to sell in a no-bid series with a minimum increment of \$0.01 and the Exchange best offer is \$0.20, the System will consider, for the remainder of the trading day, the order as a limit order with a price of \$0.01 and submit it to the Book behind other limit orders to sell at the minimum increment that are already resting in the Book. At that point, even if the series is no-bid because, for example, the last bid just traded and the limit order trades at \$0.01, the next bid entered after the trade would not be higher than \$0.20.⁶ However, if the System receives a market order to sell in a no-bid series with a minimum increment of \$0.01 and the Exchange best offer is \$1.20 (because, for example, the last bid of \$1.00 just traded), the System

⁵ The Exchange notes for informational purposes that other options exchanges have rules that address how their systems handle market orders to sell no-bid series. *See, e.g.*, NASDAQ OMX PHLX ("Phlx") Rule 1080(i) (which provides that the Phlx system will convert market orders to sell a no-bid series to limit orders to sell with a limit price of the minimum trading increment applicable to that series that are received when Phlx's disseminated quotation in the series has a bid/ask differential less than or equal to \$0.25, and will place the limit orders on the book).

⁶ If the order does not execute during the trading day as a limit order and remains outstanding after the close of trading (i.e., a GTC order), the System at that time will no longer consider the order as a limit order and will again handle the order as a market order to sell after the close of trading. The market order will stay on the Book until the opening of the next trading day (or until cancelled), at which point it may execute during the open or, if it remains unexecuted after the opening of trading, it will either execute with the best bid at the time or, if the series is still no-bid, again be handled pursuant to proposed Rule 6.12(h).

will instead cancel the order. It would be unfair to the entering firm to let its market order trade as a limit order for \$0.01 because, for example, the firm submitted the order during the brief time when there were no disseminated bids in a series trading significantly higher than the minimum increment.

The \$0.30 threshold has been in place for a number of years, and the Exchange believes the threshold is reasonable. The Exchange notes that this threshold is less than the acceptable price range (“APR”) in the price check parameter provision in Rule 6.17. Pursuant to that Rule, the System will not automatically execute a marketable order if the width between the national best bid and national best offer is not within the APR, which for an option contract with a bid of less than \$2 may not be less than \$0.375.⁷ Instead, the System will cancel the order.

Notwithstanding this provision, proposed Rule 6.12(h) allows for the potential execution of market orders to sell in no-bid series with offers less than [sic]⁸ \$0.30 as limit orders at the price of a minimum increment. If the threshold in proposed Rule 6.12(h) were higher, the risk of having a market order trade at a minimum increment in a series that is not truly no-bid would increase. This risk of execution is not present in the price check parameter provision of Rule 6.17, and therefore the Exchange believes a wider APR is appropriate for that provision.

2. Statutory Basis

⁷ Rule 6.17 also provides that the System will not automatically execute eligible orders that are marketable if the execution would follow an initial partial execution on the Exchange and would be at a subsequent price that is not within an acceptable tick distance from the initial execution. The APR for purposes of Rule 6.17 is determined by the Exchange on a class-by-class basis and may not be less than \$0.375 between the bid and offer for each option contract for which the bid is less than \$2, \$0.60 where the bid is at least \$2 but does not exceed \$5, \$0.75 where the bid is more than \$5 but does not exceed \$10, \$1.20 where the bid is more than \$10 but does not exceed \$20, and \$1.50 where the bid is more than \$20. An “acceptable tick distance” [sic] less than two minimum increments.

⁸ The Commission notes that C2’s proposed rule text actually specifies that the Exchange would convert market orders in no-bid series to limit orders where the Exchange’s best offer is less than or equal to \$.30 (emphasis added).

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.⁹ Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)¹⁰ requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, 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.

In particular, the proposed rule change protects investors and the public interest by providing investors with more clarity regarding the System's automatic order handling process — specifically how it processes market orders to sell in no-bid series. The Exchange believes that the automated handling of market orders to sell in no-bid series if the Exchange best offer is \$0.30 or less assists with the maintenance of fair and orderly markets and protects investors and the public interest because it provides for automated handling of these orders, ultimately resulting in more efficient executions of these orders. The Exchange believes that the \$0.30 threshold also protects investors and assists with the maintenance of fair and orderly markets by preventing executions of market orders to sell in no-bid series with higher offers at potentially extreme prices in series that are not truly no-bid. The Exchange believes this threshold appropriately reflects the interests of investors, as orders in no-bid series with offers higher than \$0.30 are likely not worthless. The Exchange believes an investor would not want automatic handling of these orders in this situation, as such handling could result in a sale at a significantly

⁹ 15 U.S.C. 78f(b).

¹⁰ 15 U.S.C. 78f(b)(5).

lower price than the investor could otherwise obtain if the System cancelled the order, and the investor later resubmitted the order when the series was no longer no-bid.

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 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 proposed rule change.

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

The Exchange has filed the proposed rule change pursuant to Section 19(b)(3)(A)(iii) of the Act¹¹ and Rule 19b-4(f)(6) thereunder.¹² Because the proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative prior to 30 days from the date on which it was filed, or such shorter time as the Commission may designate, if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6)(iii) thereunder.¹³

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

¹¹ 15 U.S.C. 78s(b)(3)(A)(iii).

¹² 17 CFR 240.19b-4(f)(6).

¹³ 17 CFR 240.19b-4(f)(6)(iii). In addition, Rule 19b-4(f)(6)(iii) requires a self-regulatory organization to provide the Commission with written notice of its intent to file the proposed rule change, along with a brief description and text of 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 Exchange has fulfilled this requirement.

action is necessary or appropriate in the 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-C2-2012-026 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-C2-2012-026. 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-C2-2012-026 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

Kevin M. O'Neill
Deputy Secretary

¹⁴ 17 CFR 200.30-3(a)(12).