

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68573; File No. SR-C2-2012-043)

January 3, 2013

Self-Regulatory Organizations; C2 Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change, as Modified by Amendment No. 1 Thereto, to Adopt a HAL System

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 December 21, 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, II, and III below, which Items have been prepared by the Exchange. On January 2, 2013, the Exchange submitted Amendment No. 1 to the proposed rule change.³ 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 adopt a HAL system. The text of the proposed rule change is provided in Exhibit 5. The text of the proposed rule change is also available on the Exchange’s website (<http://www.c2exchange.com/Legal/>), 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 In Amendment No. 1, the Exchange modified the description of the proposed rule change to reflect the proposed rule text that provides that HAL will be open to all Trading Permit Holders.

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 adopt a rule that governs the operation of its new HAL system ("HAL"). HAL is a feature within the C2 System that provides automated order handling in designated classes for qualifying electronic orders that are not automatically executed by the System. Regarding HAL eligibility, the Exchange shall designate eligible order size, eligible order type, eligible order origin code (i.e., public customer orders, non-Market Maker broker-dealer orders, and Market Maker broker-dealer orders), and classes in which HAL shall be activated. HAL shall automatically process upon receipt: (i) an eligible order that is marketable against the Exchange's disseminated quotation while that quotation is not the national best bid or offer ("NBBO"), unless the Exchange's quotation contains resting orders and does not contain sufficient Market-Maker quotation interest to satisfy the entire order; (ii) an eligible order that would improve the Exchange's disseminated quotation and that is marketable against quotations disseminated by other exchanges that are participants in the Options Order Protection and Locked/Crossed Market Plan (the "Linkage Plan"); or (iii) an order submitted to HAL as a result of the price check parameters of Rule 6.17.

For order handling and responses regarding HAL, orders that are received by HAL pursuant to the paragraph above shall immediately upon receipt be electronically exposed at the NBBO price. The exposure shall be for a period of time determined by the Exchange on a class-by-class basis, which period of time shall not exceed one second. All Trading Permit Holders (“TPHs”) may submit responses to the exposure message during the exposure period. Responses (i) must be priced equal to or better than the Exchange's best bid/offer; (ii) must be limited to the size of the order being exposed; and (iii) may be cancelled and/or replaced any time during the exposure period.

Regarding the allocation of exposed orders, any responses priced at the prevailing NBBO or better shall immediately trade against the order (on a first come, first served basis). At the conclusion of the exposure period, the Exchange will evaluate all remaining responses as well as the disseminated best bid/offer on other exchanges and execute any remaining portion of the exposed order to the fullest extent possible at the best price(s) by first executing against responses (pursuant to the matching algorithm in effect for the class except that the participation entitlement and market turner status shall not apply to responses), and, second, routing Immediate-or-Cancel (“IOC”) Intermarket Sweep Orders (“ISOs”) to other exchanges. Any portion of a routed IOC ISO that returns unfilled shall trade against the Exchange's best bid/offer unless another exchange is quoting at a better price in which case new IOC ISOs shall be generated and routed to trade against such better prices. Any executions at the Exchange's best bid/offer will first trade against interest that was resting at the price at the time the exposed order was received, and any remaining balance will trade against all new interest at that price (in both cases pursuant to the matching algorithm for that class). All executions on the Exchange

pursuant to this paragraph shall comply with Rule 6.81. Executions will be subject to price check parameters set forth in Rule 6.17 when such price check functionality is enabled.

Regarding the early termination of the exposure period, in addition to the receipt of a response to trade the entire exposed order at the NBBO or better, the exposure period will also terminate early under the following circumstances: (i) If during the exposure period the Exchange receives an unrelated order (or quote) on the opposite side of the market from the exposed order that could trade against the exposed order at the prevailing NBBO price or better, then the orders will trade at the prevailing NBBO price unless the unrelated order is a customer order in which case the orders will trade at the midpoint of the unrelated order's limit price and the prevailing NBBO. The exposure period shall not terminate if a quantity remains on the exposed order after such trade; (ii) If during the exposure period the Exchange receives an unrelated order on the same side of the market as the exposed order that is priced equal to or better than the exposed order, then the exposure period shall terminate and the exposed order shall be processed in accordance with paragraph (c) (which regards allocation of exposed orders); (iii) If during the exposure of an order that is marketable against the Exchange's best bid/offer at the time the order was exposed ("Exchange Initial BBO"), Market-Maker interest at the Exchange Initial BBO decrements to a contract size equal to the size of the exposed order, then the exposure period shall terminate and the exposed order shall be processed in accordance with paragraph (c) (which regards allocation of exposed orders).

The purpose of the proposed change is to provide C2 TPHs with the opportunity to improve their prices and "step up" to meet the NBBO in order to interact with orders sent to the Exchange. This will allow the market participant sending an order to C2 to increase its chances of receiving an execution at C2 (the market participant's chosen venue) instead of having the

order be routed to another exchange. This “step up” process allows market participants to take into account factors beyond just disseminated prices, such as execution costs, system reliability, and quality of service, when determining the exchange to which to route an order. A market participant that prefers C2 due to some combination of these other factors will know that, even if C2 is not displaying a price that is the NBBO, the market participant may still receive an execution at C2 because a C2 TPH may “step up” to match the NBBO.

Further, HAL and the “step up” process enable C2 TPHs to add liquidity that is available to interact with orders sent to the Exchange. Indeed, when a C2 TPH “steps up” to match the NBBO that is displayed on another exchange, more contracts may be executed at this NBBO price here on C2 than are available at that same price on the other exchange.

C2’s proposed HAL and the “step up” process are not novel concepts. C2’s proposed HAL is nearly identical to the Hybrid Agency Liaison (“CBOE HAL”) offered on the Chicago Board Options Exchange, Incorporated (“CBOE”), which provides the same manner of “step up” process. There are a couple of differences between CBOE HAL and the proposed C2 HAL. First, CBOE HAL operates on CBOE’s Hybrid Trading System, which combines both open outcry and electronic trading, whereas the proposed C2 HAL would be entirely electronic (as C2 is an all-electronic exchange). The proposed C2 HAL rule does not incorporate the minimal CBOE HAL language regarding Hybrid.⁴

Second, on CBOE HAL, only Market-Makers with an appointment in the relevant option class and TPHs acting as agent for orders resting at the top of CBOE’s book in the relevant option series opposite the order submitted to CBOE HAL may submit responses to the exposure message during the exposure period (unless CBOE determines, on a class-by-class basis, to

⁴ See CBOE Rule 6.14A.

allow all TPHs to submit responses to the exposure message). C2 has determined that, on its proposed C2 HAL, all TPHs may submit responses to the exposure message during the exposure period. As such, Interpretation and Policy .01 to CBOE Rule 6.14A (the CBOE rule regarding HAL), which prohibits the redistribution of exposure messages to market participants not eligible to respond to such messages (except in classes in which CBOE allows all TPHs to respond to such messages) does not apply to the proposed C2 HAL, as all C2 TPHs are permitted to respond to all exposure messages. Despite these differences, the proposed C2 HAL would otherwise operate in an identical manner to the CBOE HAL, which has been approved by the Securities and Exchange Commission (the “Commission”).⁵

The Exchange believes that the Commission has always been clear that honoring better prices on other markets can be accomplished by matching those better prices.⁶ The proposed HAL and a “step up” process would allow C2 TPHs to do just that. And if a C2 market participant wants to ensure that an order does not go through the proposed HAL process, that market participant can submit an Immediate-or-Cancel order (which is not exposed to HAL).

The Exchange also proposes to adopt Interpretation and Policy .01 to new Rule 6.18, which will state that the Exchange may determine, on a class-by-class basis, to not route ISOs to other exchanges on behalf of non-public customer orders that are exposed pursuant to this Rule. In such cases, any unexecuted balance of such non-public customer orders shall be cancelled at the conclusion of the exposure period. Under the Linkage Plan, the Exchange is not obligated to

⁵ See Securities Exchange Act Release No. 60551 (August 20, 2009), 74 FR 43196 (August 26, 2009) (SR-CBOE-2009-040).

⁶ For example, in adopting the Order Protection Rule (Rule 611) under Regulation NMS in 2005, the Commission stated: “The Order Protection Rule generally requires that trading centers match the best quoted prices, cancel orders without an execution, or route orders to the trading centers quoting the best prices.” See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005), at 37525 (S7-10-04).

route orders to another exchange; the Linkage Plan only requires that C2 not trade through a better price at another exchange. In certain circumstances, particularly with orders of non-public customer market participants, the Exchange may elect not to route an order to another exchange in order to not incur the costs associated with routing such order.

The Exchange also proposes to adopt Interpretation and Policy .02 to new Rule 6.18, which will state that all pronouncements regarding determinations by the Exchange pursuant to Rule 6.18 and the Interpretations and Policies thereunder will be announced to Trading Permit Holders via Regulatory Circular. This method of notification will allow the Exchange to promptly inform TPHs of any new or modification to any determinations made by the Exchange.

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.⁷ Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)⁸ 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.

Adopting HAL, a “step up” program, on C2 will provide TPHs with the opportunity to improve their prices to match the NBBO in order to interact with orders sent to the Exchange. This will allow the market participant sending an order to C2 to increase its chances of receiving an execution at C2 (the market participant’s chosen venue) instead of having the order be routed

⁷ 15 U.S.C. 78f(b).

⁸ 15 U.S.C. 78f(b)(5).

to another exchange. This “step up” process allows market participants to take into account factors beyond just disseminated prices, such as execution costs, system reliability, and quality of service, when determining the exchange to which to route an order. A market participant that prefers C2 due to some combination of these other factors will know that, even if C2 is not displaying a price that is the NBBO, the market participant may still receive an execution at C2 because a C2 TPH may “step up” to match the NBBO. Therefore, the fact that HAL allows a market participant who elects to send an order to C2 to have a greater likelihood of achieving execution at this chosen venue without the risk of paying a lower price removes an impediment to and perfects the mechanism for a free and open national market system.

Further, HAL and the “step up” process enable C2 TPHs to add liquidity that is available to interact with orders sent to the Exchange. Indeed, when a C2 TPH “steps up” to match the NBBO that is displayed on another exchange, more contracts may be executed at this NBBO price here on C2 than are available at that same price on the other exchange. This increased liquidity benefits all market participants on C2, thereby perfecting the mechanism for a free and open national market system and protecting investors and the public interest.

C2’s proposed HAL is nearly identical to CBOE HAL, which provides the same manner of “step up” process. The only differences between CBOE HAL and the proposed C2 HAL are that 1) CBOE HAL operates on CBOE’s Hybrid Trading System, which combines both outcry and electronic trading, whereas the proposed C2 HAL would be entirely electronic (as C2 is an all-electronic exchange), and 2) the proposed C2 HAL will be open to all C2 TPHs.⁹

⁹ On CBOE HAL, only Market-Makers with an appointment in the relevant option class and Trading Permit Holders acting as agent for orders resting at the top of CBOE’s book in the relevant option series opposite the order submitted to CBOE HAL may submit responses to the exposure message during the exposure period (unless CBOE determines, on a class-by-class basis, to allow all TPHs to submit responses to the exposure message)

Despite these differences, the proposed C2 HAL would otherwise operate in an identical manner to the CBOE HAL, which has been approved by the Commission.¹⁰ As such, C2 merely desires to adopt a mechanism that is nearly identical to one that already exists on CBOE. Permitting C2 to operate on an even playing field relative to other exchanges removes impediments to and to perfects the mechanism for a free and open market and a national market system.

The Commission has always been clear that honoring better prices on other markets can be accomplished by matching those better prices.¹¹ The proposed HAL and a “step up” process would allow C2 TPHs to do just that.

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. The proposed C2 HAL is open to all market participants. The “step-up” feature of the proposed C2 HAL allows for price improvement. When such price improvement is achieved via this “stepping up” to meet (or beat) the best quoted price at another exchange, market participants are able to receive the best quoted price while still achieving execution on C2, the exchange to which they elected to send their orders.

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.

¹⁰ See Securities Exchange Act Release No. 60551 (August 20, 2009), 74 FR 43196 (August 26, 2009) (SR-CBOE-2009-040).

¹¹ For example, in adopting the Order Protection Rule (Rule 611) under Regulation NMS in 2005, the Commission stated: “The Order Protection Rule generally requires that trading centers match the best quoted prices, cancel orders without an execution, or route orders to the trading centers quoting the best prices.” See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005), at 37525 (S7-10-04).

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

Because the foregoing proposed rule change does not:

- A. significantly affect the protection of investors or the public interest;
- B. impose any significant burden on competition; and
- C. become operative for 30 days from the date on which it was filed, or such shorter

time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act¹² and Rule 19b-4(f)(6)¹³ thereunder. 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 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-C2-2012-043 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.

¹² 15 U.S.C. 78s(b)(3)(A).

¹³ 17 CFR 240.19b-4(f)(6).

All submissions should refer to File Number SR-C2-2012-043. 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, NW, Washington, D.C. 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-C2-2012-043, and should be submitted on or before [insert date 21 days from the date of 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).