

(SECURITIES AND EXCHANGE COMMISSION)
(Release No. 34-79555; File No. SR-C2-2016-020)

December 14, 2016

Self-Regulatory Organizations; C2 Options Exchange, Incorporated; Order Approving a Proposed Rule Change Relating to Price Protection Mechanisms and Risk Controls

I. Introduction

On October 25, 2016, C2 Options Exchange, Incorporated (“C2” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend current and adopt new price protection mechanisms and risk controls for orders and quotes. The Commission published the proposed rule change for comment in the Federal Register on November 3, 2016.³ The Commission received no comments on the proposal. This order approves the proposed rule change.

II. Description of the Proposed Rule Change⁴

The Exchange currently has in place various price check mechanisms and risk controls that are designed to prevent incoming orders and quotes from automatically executing at potentially erroneous prices or to assist Trading Permit Holders (“TPHs”) with managing their risk.⁵ The Exchange proposed to amend C2 Rules 6.17 and 8.12 to add new, as well as amend

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 79189 (October 28, 2016), 81 FR 76671 (November 3, 2016) (“Notice”).

⁴ A more detailed description of the proposed rule change appears in the Notice. See id.

⁵ See, e.g., C2 Rules 6.13, Interpretation and Policy .04 (price check parameters for complex orders), 6.17(a) (market-width and drill through price check parameters), Rule 6.17(b) (simple limit order price parameters), 6.17(d) and (e) (price protections), and 8.12 (Quote Risk Monitor Mechanism (“QRM”).

current, price protection mechanisms and risk controls to further assist brokers in their efforts to prevent errors and avoid trading activity that could potentially be unwanted or even disruptive to the market.⁶

A. Limit Order Price Parameter for Simple Orders

The Exchange proposed to amend the limit order price parameter for simple orders in C2 Rule 6.17(b). Currently, the Exchange will not accept for execution an eligible limit order if a limit order to buy (sell) is more than an acceptable tick distance (“ATD”)⁷ above (below): (i) the Exchange’s previous day’s closing price prior to the opening of a series, or (ii) the disseminated Exchange offer (bid) once a series has opened.⁸

The Exchange has now proposed to amend C2 Rule 6.17(b) to reject a limit order to buy (sell) generally when it is more than an ATD above (below) the last disseminated national best offer (“NBO”) (national best bid (“NBB”)).⁹ According to the Exchange, using the NBBO or NBO (NBB), if available, will more accurately reflect the then current market, rather than

⁶ The proposed rule change also made conforming changes to C2 Rules 6.11, 6.14, and 6.18. A full discussion of those changes may be found in the Notice. See supra note 3.

⁷ Currently, the Exchange determines the ATD, which may be no less than 5 minimum increment ticks, on a series-by-series and premium basis. Under the proposed rule change, the ATD, which may be no less than two minimum increment ticks, will be determined on a class-by-class and premium basis. In addition, different ATDs may be applied to orders entered during the pre-opening, a trading rotation, or a trading halt. See proposed C2 Rule 6.17(b) and Notice, supra note 3, at 76673.

⁸ See C2 Rule 6.17(b).

⁹ Specifically, C2 will reject the order if it is more than the ATD above (below): (i) prior to the opening of a series, (A) the last disseminated NBO (NBB), if a series is open on another exchange, or (B) the Exchange’s previous day’s closing price, if a series is not yet open on any other exchange; if the NBBO is locked, crossed, or unavailable; or if there is no NBO (NBB) and the previous day’s closing price is greater (less) than or equal to the NBB (NBO); (ii) intraday, the last disseminated NBO (NBB), or the Exchange’s best offer (bid) if the NBBO is locked, crossed or unavailable; or (iii) during a trading halt, the last disseminated NBO (NBB).

the previous day's closing price or Exchange BBO.¹⁰ The Exchange, however, will continue to use the previous day's closing price or Exchange BBO in certain instances, such as when the NBBO is locked or crossed, or when there is no NBO (NBB) and the closing price does not cross the disseminated NBB (NBO).¹¹

C2 also proposed to apply the limit order price parameter to immediate-or-cancel orders. According to the Exchange, such orders also are at risk of execution at extreme and potentially erroneous prices and thus will benefit from applicability of these checks.¹² However, the limit order price parameter will not apply to orders with a stop contingency.¹³ According to the Exchange, buy orders with a stop contingency are generally submitted at a triggering price that is above the NBO, and sell orders with a stop contingency are generally submitted at a triggering price that is below the NBB.¹⁴ As a result, the Exchange believes these orders are expected to be priced outside the NBBO.¹⁵

B. Drill Through Price Check Parameter

The Exchange proposed to amend the drill through price check parameter in C2 Rule 6.17(a)(2). Currently, the Exchange's trading system ("System") will not automatically execute a market or marketable limit order¹⁶ if the execution would follow an initial partial

¹⁰ See Notice, supra note 3 at 76672.

¹¹ See id.

¹² See id. at 76673.

¹³ See proposed C2 Rule 6.17(b). A stop contingency is triggered for a buy order if there is a last sale or bid at or above the stop price and for a sell order if there is a last sale or offer at or below the stop price.

¹⁴ See Notice, supra note 3 at 76673.

¹⁵ See id.

¹⁶ Currently, the Exchange applies the market-width check to market orders and the drill through check to market and marketable limit orders. The Exchange proposed to codify this current practice into the rules. See Notice, supra note 3, at 76673 n.12.

execution on the Exchange at a price not within an ATD¹⁷ from the initial execution. Instead, the System cancels the remaining unexecuted portion.¹⁸

The Exchange now has proposed to amend C2 Rule 6.17(a)(2) to add detail to the rule describing how the System will handle orders in the event that the Exchange activates HAL or SAL.¹⁹ In particular, orders not previously exposed would be exposed via HAL and orders previously exposed via HAL or SAL would rest in the book for a period of time and thereafter be cancelled if they do not execute.²⁰

¹⁷ Currently, the ATD is determined by the Exchange on a series-by-series and premium basis for market orders and/or marketable limit orders and may be no less than two minimum increment ticks. Under the proposed rule change, the Exchange will determine the ATD on a class and premium basis (which may be no less than two minimum increment ticks), which the Exchange will announce via Regulatory Circular. See proposed C2 Rule 6.17(a)(2)(A).

¹⁸ See C2 Rule 6.17(c).

¹⁹ Currently, the Exchange has not activated HAL or SAL in any class. See Notice, supra note 3, at 76673 nn.13 and 15.

²⁰ Specifically, if a buy (sell) order not yet exposed via HAL partially executes, and the System determines the unexecuted portion would execute at a price higher (lower) than the price that is an ATD above (below) the NBO (NBB) (“drill through price”), the System will not automatically execute the remaining portion but will instead expose it via HAL at the better of the NBBO and the drill through price (if eligible for HAL). If a buy (sell) order exposed via HAL (other than pursuant to the previous sentence) or the Solicitation Auction Mechanism (“SAL”) would, following the exposure period, execute at a price higher (lower) than the drill through price, the System will not automatically execute the order (or unexecuted portion). These orders (or unexecuted portions) will rest in the book (based on the time at which they enter the book for priority purposes) for a time period in milliseconds with a price equal to the drill through price. The Exchange will determine the time period (not to exceed three seconds) and announce it via Regulatory Circular in the event the Exchange activates HAL or SAL. See Notice, supra note 3, at 76674. If the order (or any unexecuted portion) does not execute during that time period, the System cancels it. In classes in which the Exchange activated SAL, an order eligible for SAL would be exposed immediately and would not partially execute prior to being exposed via SAL. For this reason, SAL is not included in proposed C2 Rule 6.17(a)(2)(A). See Notice, supra note 3, at 76673 n. 15. Any order (or unexecuted portion) that by its terms cancels if it does not execute immediately (including immediate-or-cancel, fill-or-kill, intermarket sweep, and market-maker trade prevention orders) will be cancelled rather than rest in the book

Buy (sell) orders (or any unexecuted portion) that are not eligible for HAL or SAL and do not otherwise cancel by their terms will continue to be cancelled pursuant to proposed C2 Rule 6.17(a)(2)(D). In addition, the drill through price check parameter at the open will be handled pursuant to the separate process set forth in Rule 6.11(g)(2) and Interpretation and Policy .04.²¹

C. TPH-Designated Risk Settings

The Exchange proposed to amend C2 Rule 6.17 to authorize it to share TPH-designated risk settings with a TPH's Clearing TPH. The risk settings that the Exchange may share with Clearing TPHs include, but are not limited to, settings under Rule 8.12 (related to QRM) and proposed C2 Rule 6.17(g) (related to order entry and execution rate checks) and (h) (related to maximum contract size). The Exchange represented that other options exchanges have similar rules permitting them to share member-designated risk settings with other members that clear transactions on the member's behalf.²²

D. Put Strike Price/Call Underlying Value Checks

The Exchange proposed to amend the put strike price and call underlying value checks in C2 Rule 6.17(d). Currently, the System rejects back to the TPH a quote or buy limit order for (i) a put if the price of the quote bid or order is greater than or equal to the strike price of

for this time period in accordance with the definition of those order types. See proposed C2 Rule 6.17(a)(2)(C).

²¹ The proposed rule change also amended the market width price check parameter in C2 Rule 6.17(a)(1) to be determined on a class-by-class basis rather than series-by-series, as well as made additional non-substantive changes to Rule 6.17(a)(1), such as moving provisions regarding the market-width price check parameter from current paragraph (c) to proposed subparagraph (a)(1).

²² See Notice, supra note 3 at 76675. See also, e.g., Miami International Securities Exchange, LLC ("MIAX") Rule 500; NASDAQ OMX BX, Inc. ("BX") Chapter VI, Section 20; NYSE Arca, Inc. ("Arca") Rule 6.2A(a); NYSE MKT LLC ("MKT") Rule 902.1NY(a); and NASDAQ OMX PHLX LLC ("PHLX") Rule 1016.

the option, or (ii) a call if the price of the quote bid or order is greater than or equal to the consolidated last sale price of the underlying security, with respect to equity and exchange-traded fund options, or the last disseminated value of the underlying index, with respect to index options. The Exchange proposed to extend this check to apply to market orders (and any remaining size after a partial execution).²³

E. Quote Inverting NBBO Check

The Exchange proposed to amend C2 Rule 6.17(e) regarding the quote inverting NBBO check. Currently, if the Exchange is at the NBO (NBB), the System rejects a quote back to a Market-Maker if the quote bid (offer) crosses the NBO (NBB) by more than a number of ticks specified by the Exchange. If C2 is not at the NBO (NBB), the System rejects a quote back to a Market-Maker if the quote bid (offer) locks or crosses the NBO (NBB). If the NBBO is unavailable, locked, or crossed, then this check compares the quote to the BBO (if available). The rule is currently silent on what happens if the BBO is unavailable.

The Exchange has now proposed to amend Rule 6.17(e) to not apply this check to incoming quotes when the BBO is unavailable. The Exchange also proposed to amend the rule to state that it will not apply the check to incoming quotes prior to the opening of a series if the series is not open on another exchange, as well as during a trading halt.²⁴

F. Execution of Quotes that Lock or Cross NBBO

The Exchange further proposed to amend the provision concerning the execution of

²³ The Exchange will not apply these checks to market orders that execute during the opening process, however, in order to avoid impacting the determination of the opening price. According to the Exchange, separate price protections apply during the opening process, including the drill through protection in C2 Rule 6.11. See Notice, supra note 3, at 76675.

²⁴ See proposed C2 Rule 6.17(e)(2) and (3).

quotes that lock or cross the NBBO.²⁵ The rule currently states that if the System accepts a quote that locks or crosses the NBBO, it executes the quote and either (i) cancels any remainder or (ii) books any remainder if the price of the quote does not lock or cross the price of an away exchange.

The Exchange has now proposed to amend the rule to not apply the check when the NBBO is locked, crossed, or unavailable.²⁶ In addition, the Exchange proposed to authorize a senior official at the Exchange's Help Desk to determine not to apply this check in the interest of maintaining a fair and orderly market. For example, the Exchange believes it is appropriate to disable this check in response to a market event or market volatility to avoid inadvertently cancelling quotes not erroneously priced but rather priced to reflect potentially rapidly changing prices.²⁷

G. Order Entry, Execution, and Price Parameter Checks

The Exchange proposed to adopt the following four mandatory activity-based risk protections under proposed C2 Rule 6.17(g):²⁸

- (i) the total number of orders (of all order types) and auction responses entered and accepted by the System (“orders entered”);

²⁵ The Exchange proposed to move this provision from current C2 Rule 6.17(e)(iii) to proposed C2 Rule 6.17(f).

²⁶ See Notice, supra note 3, at 76676.

²⁷ See id. The Exchange represented that, pursuant to Exchange procedures, any decision to not apply the check and the reason for such decision will be documented, retained, and periodically reviewed. See id.

²⁸ Other exchanges maintain similar activity-based risk protections. See, e.g., International Securities Exchange, LLC (“ISE”) Rule 714(d) and MIAX Rule 519A.

- (ii) the total number of contracts (from orders and auction responses) executed on the System, which does not count stock contracts executed as part of stock-option orders (“contracts executed”);
- (iii) the total number of orders the System books or cancels²⁹ pursuant to the drill through price check parameter (as amended by this proposed rule change) in proposed Rule 6.17(a)(2) (“drill through events”); and
- (iv) the total number of orders the System cancels pursuant to the limit order price parameters in Rules 6.13, Interpretation and Policy .04(f) and (g), and 6.17(b) (“price reasonability events”).

When a TPH exceeds a parameter within one of the time intervals set by C2, the System will (i) reject all subsequent incoming orders and quotes, (ii) cancel all resting quotes, and (iii) for the orders entered and contracts executed checks, if the TPH requests, cancel resting orders in the manner specified by the TPH (either all orders, orders with time-in-force of day, or orders entered on that trading day).³⁰

The System will not accept new orders or quotes from a restricted acronym or login until the Exchange receives the TPH’s manual notification to reactivate its ability to send orders and quotes. While an acronym or login is restricted, a TPH may continue to interact with any resting

²⁹ As discussed above, orders (or unexecuted portions) that by their terms cancel if they do not execute immediately will be cancelled rather than rest in the book for a period of time (as proposed in this filing) pursuant to the drill through price check parameter if triggered. According to the Exchange, because these orders will not book or be cancelled pursuant to the drill through price check parameter (but rather because of their terms), these orders will not be included in the count for the drill through event check. See Notice, supra note 3, at 76676 n.32.

³⁰ The Exchange expects the initial time intervals for all these checks to be set at one and five minutes. The time intervals set by the Exchange will apply to all TPHs, who will not be able to change these time intervals. See Notice, supra note 3, at 76676 n.33.

orders (i.e., orders not cancelled pursuant to this protection) entered prior to its acronym or login becoming restricted, including receiving trade execution reports and canceling resting orders.

H. Maximum Contract Size

The Exchange proposed to adopt a maximum contract size risk control pursuant to which the System will reject a TPH's incoming order or quote (including both sides of a two-sided quote) if its size exceeds the TPH's designated maximum contract size parameter.³¹ Each TPH must provide a maximum contract size for each of simple orders, complex orders, and quotes applicable to an acronym or, if the TPH requests, a login.³²

I. Kill Switch

The Exchange further proposed to adopt a kill switch, which will be an optional tool allowing a TPH to send a message to the System to, or contact the Exchange Help Desk to request that, the Exchange cancel all its resting quotes, resting orders (either all orders, orders with time-in-force of day, or orders entered on that trading day), or both, and thereafter reject all

³¹ See proposed C2 Rule 6.17(h). The Exchange represented that other options exchanges have adopted similar functionality. See Notice, supra note 3, at 76678 n.40; MIAX Rule 519(b).

³² For purposes of determining the contract size of an incoming order or quote, the proposed rule states the contract size of a complex order will equal the contract size of the largest option leg of the order (i.e., if the order is a stock-option order, this check will not apply to the stock leg of the order). See proposed C2 Rule 6.17(h). If a TPH enters an order or quote to replace a resting order or update a resting quote, and the System rejects the incoming order or quote because it exceeds the applicable maximum contract size, the System also will cancel the resting order or any resting quote in the same series. In addition, the Exchange proposed to apply this check to paired orders submitted to AIM or SAM. Further, the Exchange proposed that for an A:AIR order, if the System rejects the agency order, then the System rejects the contra-side order; however, if the System rejects the contra-side order, the System still accepts the agency order. See proposed C2 Rule 6.17(h)(2).

subsequent incoming quotes and/or orders.³³ The System will send a TPH an automated message when it has processed a kill switch request and thereafter will not accept new orders or quotes from a restricted acronym or login until the Exchange receives the TPH's manual notification to reactivate its ability to send orders and quotes.

According to the Exchange, the kill switch message will be accepted by the System in the order of receipt in the queue and will be processed in that order so that interest already in the System will be processed prior to the kill switch message.³⁴ Moreover, a Market-Maker's utilization of the kill switch, and subsequent removal of its quotes, will not diminish or relieve the Market-Maker of its obligation to provide continuous two-sided quotes. Market-Makers will continue to be required to provide continuous two-sided quotes on a daily basis, and a Market-Maker's utilization of the kill switch will not prohibit the Exchange from taking disciplinary action against the Market-Maker for failing to meet the continuing quoting obligation each trading day.³⁵

J. Quote Risk Monitor Mechanism

Lastly, the Exchange proposed to amend the QRM Mechanism in C2 Rule 8.12. Pursuant to the QRM mechanism, a Market-Maker may establish a (i) maximum number of contracts, (ii) a maximum cumulative percentage of the original quoted size of each side of each series, and (iii) the maximum number of series for which either side of its quote is fully traded, that may trade within a rolling time period in milliseconds also established by the Market-Maker. When these parameters are exceeded within the time interval, the System cancels the Market-

³³ See proposed C2 Rule 6.17(i). The Exchange represented that other options exchanges have adopted similar kill switches. See Notice, supra note 3, at 76678; BOX Options Exchange LLC ("BOX") Rule 7280 and PHLX Rule 1019(b).

³⁴ See Notice, supra note 3 at 76681.

³⁵ See id.

Maker's quotes in the class and other classes with the same underlying. In addition, C2 Rule 8.12 allows Market-Makers or TPH organizations to specify a maximum number of QRM incidents across all classes on an Exchange-wide basis. When the Exchange determines that a Market-Maker or TPH organization has reached its QRM incident limit during the rolling time interval, the System will cancel all of the Market-Maker's electronic quotes and Market-Maker orders resting in the book in all option classes on the Exchange and prevent the Market-Maker or TPH organization from sending additional quotes or orders to the Exchange until the Market-Maker reactivates its ability to send quotes or orders.

Currently, use of the QRM is optional. The Exchange proposed to amend C2 Rule 8.12 to make it mandatory for Market-Makers to enter values for each parameter for all classes in which they quote.³⁶

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of Section 6 of the Act³⁷ and the rules and regulations thereunder applicable to the Exchange.³⁸ Specifically, the Commission finds that the proposed rule change is consistent with the Section 6(b)(5)³⁹ requirements that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in

³⁶ The Exchange represented that other options exchanges have made similar functionality mandatory for all Market-Makers. See Notice, supra note 3, at 76679; ISE Rule 804(g).

³⁷ 15 U.S.C. 78f(b).

³⁸ In approving these proposed rule changes, the Commission has considered the proposed rules' impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

³⁹ 15 U.S.C. 78f(b)(5).

securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Commission believes that the proposed rule change is designed to mitigate the likelihood of orders trading at potentially erroneous prices, clarify when certain price/risk controls will apply, and assist TPHs in managing their risk exposure to avoid potentially harmful and disruptive trading. Moreover, the Commission notes that it recently approved proposed rule changes to CBOE rules that are substantially similar to the C2 proposed rule changes that are the subject of this Order.⁴⁰

As discussed above, C2 is proposing to amend its limit order price parameter for simple orders to use the NBBO when available in lieu of the Exchange's previous day's closing price or BBO. To the extent that the use of the NBBO, when available, rather than the Exchange's previous day's closing price or BBO, may better reflect the then current market, it should provide a suitable measure for purposes of determining the reasonability of the prices of orders. Moreover, the Commission believes that it is reasonable for C2 to exclude orders with a stop contingency from the limit order price check parameter, as application of the limit order price check parameter to such orders may interfere with the application of the stop contingency.

Further, the Commission believes that the proposed rule change to expand the applicability of the put strike price and call underlying value checks to market orders⁴¹ may help TPHs mitigate risks associated with orders trading at prices that exceed a corresponding benchmark, which may indicate an execution at a price that is potentially erroneous.

⁴⁰ See Securities Exchange Act Release No. 79244 (November 4, 2016), 81 FR 79063 (November 10, 2016) (approving CBOE proposed rule changes relating to price protection mechanisms and risk controls).

⁴¹ The checks will not apply to market orders during an opening rotation since separate price protections will apply during the opening process. See Notice, *supra* note 3, at 76680.

The proposed changes to the drill through price checks provide additional detail to the rule regarding how the System will handle certain orders in the event that the Exchange activates HAL or SAL, such as orders that were not exposed prior to trading up to the drill through price and orders that traded up to the drill through price following exposure. In addition, allowing the remainder of orders to rest in the book for a brief time period at the drill through price may benefit investors by providing an additional opportunity for execution of their orders. Furthermore, clarifying that an order exposed via HAL pursuant to the drill through price check will not be exposed at a price worse than the NBBO is consistent with the current treatment of other orders exposed via HAL at the NBBO.⁴²

The Commission also believes that the proposed amendments to the quote inverting NBBO check will provide market participants with greater clarity that C2 will not apply the check in the absence of an NBBO or BBO. In addition, the proposed rule change eliminates the Exchange's flexibility to apply the check prior to the opening of a series as well as during a trading halt. Removing this flexibility and clearly stating when C2 will not apply the check considerably enhances the transparency of the functionality.

With respect to C2's proposed changes regarding the execution of quotes that lock or cross the NBBO (Proposed Rule 6.17(f)), the Commission believes that the proposed rule change to not apply the check when the NBBO is locked, crossed or unavailable, and to allow the Exchange to disable this check in the interest of maintaining a fair and orderly market, will prevent the System from cancelling quotes when there is no reliable benchmark or when prices on quotes may not be erroneous but rather reflect a rapidly changing market. Moreover, to the extent the Exchange determines to temporarily deactivate the check in the interest of

⁴² See current and proposed C2 Rule 6.18(b).

maintaining a fair and orderly market, C2 has represented that all such decisions by C2 will be adequately justified, documented, retained, and periodically reviewed.⁴³

Further, the Commission believes that the Exchange's proposed risk protection parameters and mechanisms for orders and quotes are reasonably designed to provide TPHs with additional tools to assist them in managing their risk exposure. Specifically, the order entry, execution, and price parameter rate checks, maximum contract size risk control, and mandatory use of the QRM may help TPHs to mitigate the potential risks associated with entering too many orders or quotes, executing too many contracts, having too many orders cancelled because of price protection parameters, and entering orders or quotes with size that may be potentially erroneous that may result from, for example, technology issues with the broker's electronic trading system. To this extent, these TPH-customizable settings may help act as a backstop to the TPH's own controls and provide an additional layer of protection customized to the TPH's self-selected parameters. In addition to the CBOE filing mentioned above, the Commission notes that other exchanges have established similar risk protection mechanisms.⁴⁴ The Commission notes that the proposed functionality, including the cancellation of any resting interest, must be processed in sequence with other interest in the System and comply with the firm quote obligations in Rule 602 of Regulation NMS.

C2 will require TPHs and Market-Makers to utilize these risk protection parameters and mechanisms. However, TPHs and Market-Makers will have discretion to customize the parameters in accordance with their respective risk management needs. In light of this flexibility, the Commission reminds TPHs to be mindful of their obligations, to among others, seek best execution of orders they handle on an agency basis and consider their best execution

⁴³ See supra note 27 and accompanying text.

⁴⁴ See ISE Rules 714(d) & 804(g); MIAX Rules 519(b) & 519A.

obligations when establishing parameters for the order entry, execution, price parameter rate checks, maximum contract size risk control, and QRM.⁴⁵ For example, an abnormally low order entry parameter should be carefully scrutinized, particularly if a TPH's order flow to the Exchange contains agency orders. To the extent that a TPH chooses sensitive parameters and those parameters apply to connections over which it transmits customer orders to the Exchange, a TPH should consider the effect of its chosen settings on its ability to receive a timely execution on marketable agency orders that it sends to the Exchange in various market conditions. The Commission cautions brokers considering their best execution obligations to be aware that an agency order they represent may be rejected as a result of these risk protections.

In addition, in light of the Exchange's decision not to set maximum or minimum values, or default values, the Commission expects C2 to periodically assess whether these risk protection measures are operating in a manner that is consistent with the promotion of fair and orderly markets, including whether not utilizing maximum and minimum parameters or default values continues to be appropriate and in accordance with the Act and the rules thereunder.

Further, the Commission believes that Proposed Rule 6.17(i), which creates an optional kill switch mechanism, is consistent with the Act as it may further enhance risk management capabilities of TPHs by providing them with the ability to manage their risk exposure if they experience a significant system failure. To the extent that the kill switch mechanism provides TPHs with an appropriate backstop in this manner, it may encourage firms to provide liquidity on C2 and thus contribute to fair and orderly markets in a manner that protects investors and

⁴⁵ See, e.g., Securities Exchange Act Release Nos. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996) (Order Handling Rules adopting release); 51808 (June 9, 2005), 70 FR 37496, 37537-8 (June 29, 2005) (Regulation NMS adopting release).

the public interest. The Commission notes that the Exchange represented in its proposal that the kill switch will operate consistently with a broker-dealer's firm quote obligations pursuant to Rule 602 of Regulation NMS,⁴⁶ and that the kill switch does not diminish or relieve a Market-Maker of its obligation to provide continuous two-sided quotes.⁴⁷ The Exchange also represented that the kill switch message will be accepted by the System in the order of receipt in the queue and will be processed in such order. As such, the System will process interest already in the System prior to receipt of the kill switch message prior to processing the kill switch message.⁴⁸ Based on these representations, the Commission believes that the kill switch is reasonably designed to promote just and equitable principles of trade and perfect the mechanism of a free and open market. Lastly, the Commission notes that in addition to the CBOE filing mentioned above, other exchanges have established kill switches that operate in a manner similar to that proposed by C2.⁴⁹

Finally, the Commission believes that the proposal to authorize C2 to share with Clearing TPHs the risk mitigation settings selected by a TPH for whom the Clearing TPH clears may assist Clearing TPHs manage their clearing risk exposure. In addition to the CBOE filing mentioned above, the Commission notes that other exchanges have adopted similar rules authorizing the sharing of similar risk settings with clearing members.⁵⁰

⁴⁶ See Notice, supra note 3, at 76681.

⁴⁷ See id.

⁴⁸ See id.

⁴⁹ See, e.g., BOX Rule 7280(b) and PHLX Rule 1019(b).

⁵⁰ See, e.g., MIAX Rule 500; BX Chapter VI, Section 20; NYSE Arca Rule 6.2A(a); NYSE MKT Rule 902.1NY(a); and PHLX Rule 1016.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁵¹ that the proposed rule change (SR-C2-2016-020), be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁵²

Robert W. Errett
Deputy Secretary

⁵¹ See id.

⁵² 17 CFR 200.30-3(a)(12).