

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-69082; File No. SR-CBOE-2013-030)

March 8, 2013

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of Proposed Rule Change Relating to the Regulation NMS Plan to Address Extraordinary Market Volatility

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup>, and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on March 7, 2013, Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “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 modify its rules to address certain option order handling procedures and quoting obligations on the Exchange after the implementation of the market wide equity Plan to Address Extraordinary Market Volatility (the “Plan”).

The text of the proposed rule change is available on the Exchange’s website (<http://www.cboe.com/AboutCBOE/CBOELegalRegulatoryHome.aspx>), at the Exchange’s Office of the Secretary, 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

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange is proposing to update Exchange rules to correspond with the Plan. Specifically, the Exchange is proposing to make proposed changes to Exchange Rules Rule 6.2B, "Hybrid Opening System ("HOSS"), 6.3A, "Equity Market Trading Halt," Rule 6.14A, "Hybrid Agency Liaison," Rule 6.25, "Nullification and Adjustment of Options Transactions," Rule 6.53, "Certain Types of Orders Defined," Rule 6.53C, "Complex Orders on the Hybrid System," Rule 8.7, "Obligations of Market-Makers, Rule 8.13, "Preferred Market-Maker Program," Rule 8.15A "Lead Market-Maker in Hybrid Classes," Rule 8.85, "DPM Obligations," and Rule 8.93, "e-DPM Obligations." The Exchange believes these modifications will protect investors because when an underlying security is in a limit or straddle state (collectively referred to in this filing as a "limit up-limit down state"), there will not be a reliable price for the security to serve as a benchmark for the price of the option. In addition, the width of the markets might be compromised and, thus, the quality of execution for retail customers. The Plan is more fully explained below.

In an attempt to address extraordinary market volatility in NMS Stock, and, in particular, events like the severe volatility on May 6, 2010, the Exchange, in conjunction with the other national securities exchanges and the Financial Industry Regulatory Authority, Inc. (collectively, "Participants") drafted the Plan pursuant to Rule 608 of Regulation NMS and under the

Securities Exchange Act of 1934 (the “Act”).<sup>3</sup> The Plan is primarily designed to, among other things, address extraordinary market volatility in NMS stocks, protect investors, and promote fair and orderly markets. The Plan provides for market-wide limit up-limit down requirements that prevent trades in individual NMS Stocks from occurring outside of specified price bands, as defined in Section I(N) of the Plan. These requirements would be coupled with trading pauses, as defined in Section I(Y) of the Plan, to accommodate more fundamental price moves (as opposed to erroneous trades or monetary gaps of liquidity).

The Plan was filed on April 5, 2011 by the Participants for publication and comment.<sup>4</sup> The Participants requested the Commission approve the Plan as a one-year pilot. On May 24, 2012, the Participants filed an amendment to the Plan which clarified, among other things, the calculation of the reference price, as defined in Section I(T) of the Plan, potential for order type exemption, and the creation of an Advisory Committee.<sup>5</sup> On May 31, 2012, the Commission approved the Plan, as amended, on a one-year pilot basis.<sup>6</sup>

Under the Plan, Participants are required to adopt certain rules in order to comply. Specifically, Section VI of the Plan sets forth the limit up-limit down requirements of the Plan, and in particular, that all trading centers in NMS Stocks, including both those operated by the Participants and those operated by member of Participants, shall establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trades at prices that are below the lower price band or above the upper price band for an NMS Stock, consistent with the

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<sup>3</sup> See Securities Exchange Act Release No. 64547 (May 25, 2011), 76 FR 31647 (June 1, 2011)(File No. 4-631).

<sup>4</sup> Id.

<sup>5</sup> See Securities and Exchange Act Release No. 67091 (May 31, 2012), 77 FR 33498 (June 6, 2012) (File No. 4-631).

<sup>6</sup> See Securities and Exchange Act Release No. 67091 (May 31, 2012) 77 FR 33498 (June 6, 2012).

Plan. Price Bands will be calculated by Securities Information Processors (“SIPs”) responsible for consolidation of information for an NMS Stock pursuant to Rule 603(b) of Regulation NMS under the Act. As proposed, and approved, the Plan will be implemented, as a one year pilot program, in two phases.<sup>7</sup> Phase I will become effective April 8, 2013 and apply to Tier I NMS Stocks per Appendix A of the Plan, and Phase II would become effective six months later, or earlier if announced by the SIPs 30 days prior, and would apply to all NMS Stocks.

Under the Plan, when one side of the market for an individual security is outside the applicable price band, the SIPs will be required to disseminate such National Best Bid or National Best Offer with an appropriate flag identifying it as non-executable. When the other side of the market reaches the applicable price band, the market for an individual security will enter a limit state. Trading for that security will exit the limit state if, within 15 seconds of entering the limit state, all limit state quotations were executed or cancelled. If the market does not exit a limit state within 15 seconds, then the primary listing exchange will declare a five-minute trading pause, which will be applicable to all markets trading the security.

Though the Plan is primarily designed for equity markets, the Exchange believes it will, indirectly, potentially impact the options markets as well. Thus, as stated above, the Exchange is proposing to amend its rules to ensure the option markets are not harmed as a result of the Plan’s implementation. As such, the Exchange is proposing to amend various rules to reflect such changes. The Exchange believes such changes will protect participants, the Exchange and investors in general.

First, the Exchange is proposing to add Rule 6.3A to codify the changes throughout the Exchange’s rules. Currently, Rule 6.3A is titled “Equity Market Trading Halts” and has been

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<sup>7</sup> Id.

deleted in its entirety. The Exchange is proposing to amend the title to “Equity Market Plan to Address Extraordinary Market Volatility” and add text. Rule 6.3A will define the Plan as it applies to the Exchange. In addition, the proposed rule change will describe the location of the other rule changes associated with the Plan. In essence, the proposed changes to Rule 6.3A will serve as a roadmap for the Exchange’s universal changes due to the implementation of the Plan. The proposed rule changes will list changes to Exchange order types, order handling, obvious error, and market-maker quoting obligations that the Exchange is proposing to make in connection with the implementation of the Plan. These rule changes are more thoroughly described in various sections of the Exchange Rulebook, but having one place referencing all rules associated with the Plan will serve to better protect investors by making the other rules easily located. The Exchange believes the proposed changes to Rule 6.3A will describe to Trading Permit Holders (“TPHs”), and other participants, where to find the changes associated with the Plan and will, thus, attempt to maintain a more orderly market.

Next, the Exchange is proposing to modify its opening procedures under Rule 6.2B, “Hybrid Opening System” (“HOSS”). The Exchange is proposing to add an Interpretation and Policy .07 to clarify that if the underlying security for a class of options enters into a limit up-limit down state when the class moves to opening rotation, any market orders entered that trading day will be cancelled. The Exchange believes that by cancelling the market orders, it will comply with the Plan by not allowing orders outside of the Price Bands to execute. As an exception, market orders that are considered limit orders pursuant to Rule 6.13(b)(iv) and entered the previous trading day will remain in the Book. The Exchange is proposing to allow such market orders to remain in the Book because these essentially act as limit orders at the minimum increment. Cancelling such orders could potentially cause such orders to lose their priority with

respect to other market orders in the Book.

Next, the Exchange is proposing to modify Exchange Rule 6.14A, “Hybrid Agency Liaison – (HAL).” Exchange Rule 6.14A currently governs the operation of HAL, a feature within the Hybrid System that provides automated order handling in designated classes trading on the Hybrid System for qualifying electronic orders that are not automatically executed by the Hybrid System. The Exchange determines the eligible order size, eligible order types, eligible origin code (i.e. public customer orders, non-Market-Maker broker-dealer orders and Market-Maker broker-dealer orders), and classes in which HAL is activated.<sup>8</sup> When the Exchange receives a qualifying order that is marketable against the National Best Bid or Offer (“NBBO”) and/or the Exchange’s best bid or offer (“BBO”)<sup>9</sup>, HAL electronically exposes the order<sup>10</sup> at the NBBO price to allow Market-Makers appointed in that class, as well as all TPHs acting as agent for orders, at the top of the Exchange’s book in the relevant series (or all TPHs if allowed by the Exchange) to step-up to the NBBO price.

Because the underlying security of the option in HAL affects the pricing of the eventually executed order, the Exchange is proposing to make changes to Rule 6.14A to reflect the implementation of the Plan. More specifically, the Exchange is proposing to amend Rule 6.14A to modify the behavior of HAL of a market order while the underlying security of the option is in a limit up-limit down state. If an underlying security shall enter a limit up-limit down state while a HAL of a market order is in process, the auction will end early, upon the entering of the state.

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<sup>8</sup> Rule 6.14A(a).

<sup>9</sup> HAL will not electronically expose the order if the Exchange’s quotation contains resting orders and does not contain sufficient Market-Maker quotation interest to satisfy the entire order.

<sup>10</sup> The duration of the exposure period may not exceed one second. Rule 6.14A(c) describes the manner in which an exposed order is allocated under HAL, and Rule 6.14A(d) lists the circumstances in which an exposure period would terminate early.

Any unexecuted portion of the market order shall be cancelled. The Exchange believes the proposed rule changes will best protect the TPH by ensuring it does not receive an executed order with an unanticipated price due to the change in the underlying security. In addition, by ending the auction early, the Exchange is providing a better chance for the TPH to get its order executed as it is in the TPH's interest for an earlier execution versus a later one.

Next, the Exchange is proposing to modify how an electronic complex order request for responses ("RFR") auction ("COA") will operate while the underlying security of at least one of the options has entered a limit state. Exchange Rule 6.53C(d) currently describes the general COA process. Generally, on a class-by-class basis, the Exchange may activate COA, which is a process by which eligible complex orders<sup>11</sup> are given an opportunity for price improvement before being booked in the electronic complex order book ("COB") or once on a PAR workstation. On receipt of a COA-eligible order and request from a TPH representing the order that it be COA'd, the Exchange will send an RFR message to all TPHs who have elected to receive RFR messages.<sup>12</sup> Each Market-Maker with an appointment in the relevant option class and each TPH acting as agent for orders resting at the top of the COB in the relevant options

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<sup>11</sup> An eligible complex order, referred to in Rule 6.53C as a "COA-eligible order," means a complex order that, as determined by the Exchange on a class-by-class basis, is eligible for a COA considering the order's marketability (defined as a number of ticks away from the current market), size, complex order type and complex order origin type (*i.e.* non-broker-dealer public customer, broker-dealers that are not Market-Makers or specialists on an options exchange, and/or Market-Makers or specialists on an options exchange). All determinations by the Exchange on COA-eligible order parameters are announced to Trading Permit Holders by Regulatory Circular. See Rule 6.53C(d)(i)(2) and Interpretation and Policy .01 to Rule 6.53C.

<sup>12</sup> See Rule 6.53C(d)(ii). The RFR message will identify the component series, the size of the COA-eligible order and any contingencies, but will not identify the side of the market.

series may then submit responses to the RFR message during the Response Time Interval.<sup>13</sup> The Exchange is proposing to add to the COA rule that if, during COA of a market order, the underlying security of an option enters a limit up-limit down state, the COA will end upon the entering of that state and the remaining portion of the order, if a market order, will cancel. The Exchange believes this change will best protect investors as, must [sic] like HAL, the TPH may receive a skewed price of the underlying security which would impact the price of the option.

Next, the Exchange is proposing to amend Exchange Rule 6.25 relating to the nullification and adjustment of options transactions. Under the current rule, an Obvious Pricing Error occurs when the execution price of an electronic transaction is above or below the Theoretical Price for the series by a specified amount. For purpose of the rule, the “Theoretical Price” of an option series is currently defined, for series traded on at least one other options exchange, as the last national best bid price with respect to an erroneous sell transaction and the last national best offer price with respect to an erroneous buy transaction, just prior to the trade. If there are no quotes for comparison, Trading Officials<sup>14</sup> determine the Theoretical Price.

Because the theoretical price may be unreliable due to the underlying security entering a limit up-limit down state, the Exchange is proposing to amend the Exchange obvious error rules to provide that the Exchange may not nullify or adjust executed orders when the underlying security is in a limit up-limit down state. The Exchange is also proposing to add language specifying that transactions in options that overlay a security that is in a limit state may,

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<sup>13</sup> See Rule 6.53C(d)(iii). A “Response Time Interval” means the period of time during which responses to the RFR may be entered, the length of which is determined by the Exchange on a class-by-class basis but may not exceed three seconds. See Rule 6.53C(d)(iii)(2).

<sup>14</sup> The term “Trading Officials” currently means two Exchange members designated as Floor Officials and one member of the Exchange’s staff designated to perform Trading Official functions. See Rules 6.25.02 and 24.16.02.

however, be reviewed on an Exchange motion. The Exchange believes this will best protect the market because it allows limit orders to be executed on the Exchange while the underlying securities are in limit states regardless of the calculated theoretical price. Finally, the Exchange is proposing to add language to specify that this provision will be on a one year pilot basis to coincide with the Plan. The Exchange will provide the Commission with data and analysis during the duration of this pilot as requested.

In addition, the Exchange believes the proposed rule change would protect against TPHs getting a potential second look at transactions that happened during limit states that could be unfair to other participants. The proposed rule change would encourage added liquidity on the Exchange as the proposed changes would help to ensure that limit orders that are filled during a limit up-limit down state would have certainty of execution. By allowing the Exchange to continue to review such transactions on their own motion, the Exchange is further attempting to protect investors and maintain an orderly market. The Exchange believes that the combination of encouraging TPHs to participate on the market and allowing a safeguard to erroneous trades will provide the best solution during the pilot of the Plan.

Next, the Exchange is proposing to modify Rule 6.53 and 6.53C and, more specifically, how certain Exchange order types will be handled while the underlying security of such orders enters into a limit up-limit down state. The proposed rule change will, among other things,

address how market orders<sup>15</sup>, market-on-close<sup>16</sup>, stop orders<sup>17</sup>, and stock option orders<sup>18</sup> will function on the Exchange upon the implementation of the Plan. More specifically, the Exchange is proposing to add language to clarify that: (a) market orders will be returned during limit up-limit down states, (b) market-on-close orders will not be elected if the underlying security is in a limit up-limit down state<sup>19</sup>, (c) stop orders will be held while the underlying security is in a limit up-limit down state, and (d) stock-option orders will only execute if the calculated stock price is within the permissible bands.<sup>20</sup> In addition, during a limit up-limit down state, if a message is sent to replace a limit order with a market order, the resting limit order will be cancelled and the replaced market order will also be cancelled.

When a stock is in a limit or straddle state, while options trading will continue, there will not be a reliable price for a security to serve as a benchmark for the price of the option. In addition, without a reliable underlying stock price, there is an enhanced risk of errors and

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<sup>15</sup> See Exchange Rule 6.53(a) which defines a market order as “an order to buy or sell a stated number of options contracts at the best price obtainable when the order reaches the post.”

<sup>16</sup> See Exchange Rule 6.53(c)(ii) which defines a market-on-close order designation as an order “to be executed as close as possible to the closing bell, or during the closing rotation, and should be near to or at the closing price for the particular series of option contracts.”

<sup>17</sup> See Exchange Rule 6.53(c)(iii) which defines a stop order contingency to an order as one that “to buy or sell when the market for a particular option contract reaches a specified price on the CBOE floor.”

<sup>18</sup> See Exchange Rule 6.53C(a)(2) which defines a stock-option order as “an order to buy or sell a stated number of units of an underlying stock or a security convertible into the underlying stock . . . coupled with the purchase or sale of options contract(s) on the opposite side of the market.”

<sup>19</sup> During closing rotation, the Exchange will continue to re-evaluate the state of underlying securities for which the overlying securities have not yet been closed. If upon re-evaluation the underlying security should exit a limit up-limit down state, a market-on-close order may be executed.

<sup>20</sup> If the calculated price of a stock-option order is not within the permissible Price Bands, the stock-option order will be routed for manual handling.

improper executions. With these concerns in mind, the Exchange believes that adding a level of certainty for TPHs will encourage participation on the Exchange whilst the underlying securities are in limit up-limit down states. Thus, the Exchange believes handling these certain orders in this way will best protect the investor after the implementation of the Plan by not allowing execution at unreasonable prices due to the shift in the stock prices.

Finally, the Exchange is proposing to eliminate all market maker obligations for options in which the underlying security is in a limit up-limit down state while the underlying security is in the limit state. Currently, Exchange Rules 8.7, 8.13, 8.15A, 8.85, and 8.93 impose certain obligations on Market-Makers<sup>21</sup>, PMMs<sup>22</sup>, LMMs<sup>23</sup>, DPMs<sup>24</sup>, and e-DPMs<sup>25</sup>, respectively, including obligations to provide continuous electronic quotes. Upon implementation of the recent rule change to Market-Maker's continuous quoting obligations,<sup>26</sup> Rules 8.7, 8.13, 8.15A,

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<sup>21</sup> See Exchange Rule 8.1, which defines a "Market-Maker" as "an individual Trading Permit Holder or a TPH organization that is registered with the Exchange for the purpose of making transactions as a dealer specialist on the Exchange . . . ."

<sup>22</sup> See Exchange Rule 8.13, which defines a "Preferred Market-Maker" as a specific Market-Maker designated by a Trading Permit Holder to receive that Trading Permit Holder's orders in a specific class.

<sup>23</sup> See Exchange Rule 8.15A, which defines a "Lead Market-Maker" as a Market-Maker in good standing appointed by the Exchange "in an option class for which a DPM has not been appointed . . . ."

<sup>24</sup> See Exchange Rule 8.80, which defines a "Designated Primary Market-Maker" as a "TPH organization that is approved by the Exchange to function in allocated securities as a Market-Maker . . . and is subject to the obligations under Rule 8.85 . . . ."

<sup>25</sup> See Exchange Rule 8.92, which defines an "Electronic DPM" as a "TPH Organization that is approved by the Exchange to remotely function in allocated option classes as a DPM and to fulfill certain obligations required of DPMs . . . ."

<sup>26</sup> The Exchange recently proposed to, among other things, (a) reduce to 90% the percentage of time for which a Market-Maker is required to provide electronic quotes in an appointed option class on a given trading day and (b) to increase to the lesser of 99% or 100% minus one call-put pair the percentage of series in which Lead Market-Makers, Designated Primary Market-Makers and Electronic Designated Primary Market-Makers must provide continuous electronic quotes in their appointed classes, which proposed rule

8.85, and 8.93 will require that Market-Makers generally maintain continuous electronic quotes as follows:

- Rule 8.7(d)(ii)(B) will require that Market-Makers provide continuous electronic quotes when quoting in a particular class on a given trading day in 60% of the non-adjusted option series of the Market-Maker's appointed class that have a time to expiration of less than nine months;
- Rule 8.13(d) will require that PMMs provide continuous electronic quotes when the Exchange is open for trading in at least the lesser of 99% or 100% minus one call-put pair<sup>27</sup> of the non-adjusted option series of each class for which it receives Preferred Market-Maker orders;

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change was immediately effective upon filing. See Securities Exchange Act Release No. 67410 (July 11, 2012), 77 FR 42040 (July 17, 2012) (SR-CBOE-2012-064); see also Securities Exchange Act Release No. 67644 (August 13, 2012), 77 FR 49846 (August 17, 2012) (SR-CBOE-2012-077) (immediately effective rule change to delay the implementation date of the proposed rule change in rule filing SR-CBOE-2012-064 and to indicate that the Exchange will announce the new implementation date by Regulatory Circular); see also Securities and Exchange Act Release No. 68218 (November 13, 2012), 77 FR 69667 (November 20, 2012) (SR-CBOE-2012-106) (immediately effective rule change to further delay the implementation date of the proposed rule change in rule filing SR-CBOE-2012-064 and to indicate that the Exchange will announce the new implement date by Regulatory Circular). In addition, the Exchange recently filed an effective rule proposing to exclude series that have a time to expiration of nine months or more from Exchange Preferred Market Maker's continuous quoting obligation. See Securities and Exchange Act Release No. 68691 (January 18, 2013), 78 FR 5548 (January 25, 2013)(SR-CBOE-2013-008). Finally, the Exchange recently filed a rule proposing to exclude series that are added during the trading day from Exchange Market Maker's continuous quoting obligation. See Securities and Exchange Act Release No. 34-68944, 78 FR 12377. The rule text in this filing includes the effective (but not implemented) changes to the rule text made by rule filings SR-CBOE-2012-064 and SR-CBOE-2013-008. The Exchange expects to implement the effective rule changes to quoting obligations in filings SR-CBOE-2012-064 and SR-CBOE-2013-008 in conjunction with the approval of the proposed rule change in SR-CBOE-2013-019.

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A "call-put pair" is one call and one put that cover the same underlying instrument and have the same expiration date and exercise price.

- Rule 8.15A(b)(i) will require that LMMs provide continuous electronic quotes when the Exchange is open for trading in at least the lesser of 99% or 100% minus one call-put pair of the non-adjusted option series within their assigned classes;
- Rule 8.85(a)(i) will require DPMs to provide continuous electronic quotes when the Exchange is open for trading in at least the lesser of 99% or 100% minus one call-put pair of the non-adjusted option series of each class allocated to it; and
- Rule 8.93 will require e-DPMs to provide continuous electronic quotes when the Exchange is open for trading in at least the lesser of 99% or 100% minus one call-put pair of the non-adjusted option series of each allocated class.

Exchange Rules 8.13, 8.15B, and 8.87 provide that PMMs, LMMs, and DPMs, and e-DPMs, respectively, generally will receive the following participation entitlements in their assigned classes when quoting at the best price if they satisfy their obligations and other conditions set forth in the rules:

- Rule 8.13(c) provides that a PMM will receive a participation entitlement of 40% when there are two or more Market-Makers quoting at the best price on the Exchange and 50% when there is only one other Market-Maker quoting at the best price on the Exchange;
- Rule 8.15B(c) provides that an LMM will receive a participation entitlement of 50% when there is one Market-Maker also quoting at the best price on the Exchange, 40% when there are two Market-Makers also quoting at the best price on the Exchange, and 30% when there are three or more Market-Makers also

quoting at the best price on the Exchange<sup>28</sup>; and

- Rule 8.87(b)(2) provides that the collective DPM/e-DPM participation entitlement will be 50% when there is one Market-Maker also quoting at the best price on the Exchange, 40% when there are two Market-Makers also quoting at the best price on the Exchange, and 30% when there are three or more Market-Makers also quoting at the best price on the Exchange.<sup>29</sup>

Once the Exchange implements the rule change referenced above, Exchange Rule 1.1(ccc) will provide that a Market-Maker who is obligated by CBOE Rules to provide continuous electronic quotes will be deemed to have provided “continuous electronic quotes” if the Market-Maker provides electronic two-sided quotes for 90% of the time that the Market-Maker is required to provide electronic quotes in an appointed option class on a given trading day. The rule will still provide that if a technical failure or limitation of a system of the Exchange prevents the Market-Maker from maintaining, or from communicating to the Exchange, timely and accurate electronic quotes in a class, the duration of such failure will not be considered in determining whether the Market-Maker has satisfied the 90% quoting standard with respect to that option class. In addition, the rule will still provide that the Exchange may consider other exceptions to this continuous electronic quote obligation based on demonstrated legal or regulatory requirements or other mitigating circumstances.

Because prices may be skewed due to the underlying security being in a limit up-limit

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<sup>28</sup> If more than one LMM is entitled to a participation entitlement, the entitlement will be distributed equally among eligible LMMs.

<sup>29</sup> The participation entitlements of PMMs, LMMs, DPMs and e-DPMs are based on the number of contracts remaining after all public customer orders in the book at the best price on the Exchange have been satisfied. Additionally, a PMM, LMM, DPM or e-DPM may not be allocated a total quantity greater than the quantity for which the PMM, LMM, DPM or e-DPM is quoting at the best price. See Rules 8.13(c)(i) and (ii) (PMMs), 8.15B(b) and (c) (LMMs), and 8.87(b)(1)(ii) and (iii) (DPMs and e-DPMs).

down state, the Exchange is proposing to eliminate all market-maker quoting obligations in series of options that the underlying security is currently in a limit up-limit down state. Because of the direct relationship between an options price and the price of the associated underlying security, the Exchange believes eliminating all Market-Maker obligations in connection with the implementation of the Plan is the most effective way to ensure the options markets will not be compromised. Because a bid or offer of an underlying security may not be executable due to a limit or straddle state, the ability to hedge the purchase or sale of an option may not be possible or, in the least, is at risk. Because of this reason, the Exchange is anticipating that Exchange Market-Makers will be forced to change behaviors. In addition, the Exchange believes other options markets will be implementing similar changes. In an effort to protect the investors in the options market while the underlying security is in a limit up-limit down state, the Exchange believes that eliminating quoting obligations is the more effective way for this protection.

The Exchange, however, is proposing that Market-Makers may still receive participation entitlements pursuant to the proposed rules in all series in their assigned classes in which they are quoting, even in series in which they are not required to provide continuous electronic quotes under the Exchange Rules. Market-Makers already receive participation entitlements in series they are not required to quote. For example, a DPM is currently required to provide continuous electronic quotes in at least 90% of the non-adjusted option series of each multiply listed option class allocated to it and in 100% of the non-adjusted option series of each singly listed option class allocated to it for 99% of the trading day.<sup>30</sup> If the DPM elects to quote in 100% of the non-adjusted series in a multiply listed option class allocated to it, it will receive a participation entitlement in all of those series when quoting at the best price, including the 10% of the series in

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<sup>30</sup> As discussed above, this obligation will change upon implementation of a recent rule change. See supra note 26.

which it is not required to quote in. Thus, under the proposed rule change, the market would continue to function as it does now with respect to how entitlements are allocated to Market-Makers. The Exchange believes this benefit is appropriate, as it incentivizes Market-Makers to quote in as many series as possible in their appointed classes, even those series in which the underlying security has entered into a limit up-limit down state. The Exchange is attempting to better encourage Market-Makers to quote though they will not be obligated to. If they do choose to quote, the Exchange believes they should be entitled to receive the Entitlement for such quoting as appropriate.

The Exchange believes the combination of these modifications will protect investors because when an underlying security is in a limit up-limit down state, there will not be a reliable price for the security to serve as a benchmark for the price of the option. In addition, the width of the markets might be compromised and, thus, the quality of execution for retail customers. At the same time, the Exchange believes the proposed rule change will create more certainty on the options markets encouraging more investors to participate despite the changes associated with the Plan.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Securities Exchange Act of 1934 (the “Act”) and the rules and regulations thereunder applicable to the Exchange and, in particular, the requirements of Section 6(b) of the Act.<sup>31</sup> Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>32</sup> 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

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<sup>31</sup> 15 U.S.C. 78f(b).

<sup>32</sup> 15 U.S.C. 78f(b)(5).

coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in 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. Additionally, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>33</sup> requirement that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers .

In particular, the Exchange believes the proposed changes will be in accordance with the Act as they are merely intended to ensure the options markets will continue to remain just and equitable with the implementation of the Plan which is intended to reduce the negative impacts of a sudden, unanticipated price movement in NMS stocks. The proposed rule changes would promote this intention in the options markets while protecting investors participating there. In addition, similar rule changes will be adopted by other markets in the national market system in a coordinated manner promoting the public interest. Creating a more orderly market will promote just and equitable principles of trade by allowing investors to feel more secure in their participation in the national market system after the implementation of the Plan.

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

CBOE 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. Specifically, the Exchange believes the proposed changes will not impose any burden on intramarket competition because it applies to all TPHs equally. The Exchange does not believe the proposed changes will impose any burden on intermarket competition as the changes are merely being made to protect investors with the implementation of the Plan. In addition, the

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<sup>33</sup>

Id.

proposed changes will provide certainty of treatment and execution of options orders during periods of extraordinary market volatility.

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

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](mailto:rule-comments@sec.gov). Please include File No. SR-CBOE-2013-030 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 No. SR-CBOE-2013-030. 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 No. SR-CBOE-2013-030 and should be submitted on or before [insert date 15 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>34</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>34</sup> 17 CFR 200.30-3(a)(12).