

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-79540; File No. SR-CBOE-2016-082)

December 13, 2016

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change Related to Rules Regarding the Responsibility for Ensuring Compliance with Open Outcry Priority and Allocation Requirements and Trade-Through Prohibitions

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 1, 2016, Chicago Board Options Exchange, Incorporated (the “Exchange” or “CBOE”) 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. 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 seeks to amend Exchange rules regarding responsibilities for ensuring compliance with open outcry priority and allocation requirements and Trade-Through prohibitions. The text of the proposed rule change is provided below.

(additions are underlined; deletions are [bracketed])

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**Chicago Board Options Exchange, Incorporated  
Rules**

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**Rule 6.45A. - Priority and Allocation of Equity Option Trades on the CBOE Hybrid System**

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

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

**... Interpretations and Policies:**

**.01-.04** No change.

.05 For an open outcry transaction between a Floor Broker and Market-Maker it is the responsibility of the initiator of the transaction to ensure that the transaction is executed in accordance with the priority and allocation provisions set forth in Rule 6.45A(b) and does not cause a Trade-Through (unless otherwise excepted) under Rule 6.81. For an open outcry transaction between a Floor Broker and another Floor Broker or between a Market-Maker and another Market-Maker, both parties to the transaction are responsible for ensuring the transaction is executed in accordance with the aforementioned Rules.

**Rule 6.45B - Priority and Allocation of Trades in Index Options and Options on ETFs on the CBOE Hybrid System**

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**... Interpretations and Policies:**

**.01-.05** No Change.

.06 For an open outcry transaction between a Floor Broker and Market-Maker it is the responsibility of the initiator of the transaction to ensure that the transaction is executed in accordance with the priority and allocation provisions set forth in Rule 6.45B(b) and does not cause a Trade-Through (unless otherwise excepted) under Rule 6.81. For an open outcry transaction between a Floor Broker and another Floor Broker or between a Market-Maker and another Market-Maker, both parties to the transaction are responsible for ensuring the transaction is executed in accordance with the aforementioned Rules.

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**Rule 6.73. Responsibilities of Floor Brokers**

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**... Interpretations and Policies:**

**.01-.06** No change.

.07 For an open outcry transaction between a Floor Broker and Market-Maker it is the responsibility of the initiator of the transaction to ensure that the transaction is executed in accordance with the priority and allocation provisions set forth in Rules 6.45A(b) and 6.45B(b) and does not cause a Trade-Through (unless otherwise excepted) under Rule 6.81. For an open outcry transaction between a Floor Broker and another Floor Broker or between a Market-Maker and another Market-Maker, both parties to the transaction are responsible for ensuring the transaction is executed in accordance with the aforementioned Rules.

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The text of the proposed rule change is also 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 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 amend CBOE Rules 6.45A, 6.45B, and 6.73 to identify the party to a transaction that is responsible for ensuring that a transaction is executed in accordance with the priority and allocation requirements as set forth in Rules 6.45A(b) and 6.45B(b)<sup>3</sup> and does not cause a "Trade-Through" (unless otherwise excepted) under Rule 6.81.<sup>4</sup> The Exchange does not seek to absolve TPHs of the responsibility to ensure transactions are executed in

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<sup>3</sup> Rules 6.45A(b) and 6.45B(b) set forth the Exchange's rules related to the allocation of orders represented in open outcry. Specifically, Rules 6.45A(b) and 6.45B(b) provide, among other things, that where two or more bids (offers) for the same option contract represent the highest (lowest) price, public customer orders in the electronic book shall have first priority.

<sup>4</sup> A "Trade-Through" is a transaction in an options series, either as principal or agent, at a price that is lower than a Protected Bid or higher than a Protected Offer. CBOE Rule 6.81 provides that unless an exception applies, Trading Permit Holders ("TPHs") shall not effect Trade-Throughs.

accordance with the priority and allocation provisions or the Trade-Through prohibition provisions. Rather, the Exchange seeks to specify that the party or parties responsible for ensuring transactions are executed in accordance with the priority and allocation provisions and Trade-Through prohibitions is the initiator of the transaction when a Floor Broker is trading with a Market-Maker, both parties when a Floor Broker trades with a Floor Broker, and both parties when the transaction is between Market-Makers.<sup>5</sup>

Currently, if a transaction executed on the trading floor is executed at a Trade-Through price or was executed in violation of book priority, the Trade-Through or book priority violations are enforced against both parties to the transaction. With respect to transactions between Floor Brokers and transactions between Market-Makers, both parties will continue to be held responsible for the above violations. With respect to transactions between a Floor Broker and a Market-Maker, the Exchange believes the party that should be held responsible is the party that initiated the transaction on the trading floor. Generally speaking, Floor Brokers are the parties that initiate transactions on the trading floor by representing orders and executing the orders against bids and offers of other in-crowd market participants, including Market-Makers. For example, a typical open outcry transaction consists of a Floor Broker representing an order and requesting a quote from Market-Makers in the trading crowd. Market-Makers respond to the representation by indicating they are willing to buy (bid) the particular options series at X price and sell (offer) at Y price, which are based on the Market-Makers' theoretical values for the particular options. If the quoted market meets the requirements of the order as specified by the

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<sup>5</sup> In the case of a Floor Broker initiating a transaction with multiple counterparties, any Floor Broker counterparty would be held responsible in the same manner as a Floor Broker trading with one other Floor Broker. Similarly, in the case of a Market-Maker initiation [sic] a transaction with multiple counterparties, any Market-Maker counterparty would be held responsible in the same manner as a Market-maker initiation [sic] a transaction with one other counterparty.

Floor Broker's client the Floor Broker executes the order against the best quoted bid or offer price(s). The Floor Broker, as initiator, controls the order and the execution price of the order; thus, it follows that the Floor Broker in this example should be responsible for ensuring priority and allocation consistent with the applicable rules and that Trade-Through requirements are satisfied.

Floor Brokers are also in a good position to prevent Trade-Throughs and book priority violations because Floor Brokers may utilize the Public Automatic Routing System ("PAR") to execute orders, which is not available to Market-Makers. PAR provides all of the necessary market data to avoid Trade-Throughs and book priority violations (e.g., PAR includes data related to electronic public customer books, CBOE best bid and offer ("BBO"), and national best bid and offer ("NBBO"), etc.). In addition, PAR calculates and displays a net price for complex orders held by a Floor Broker. Most importantly, however, PAR offers alerts that warn Floor Brokers that a proposed execution price for a given order may violate priority or result in a potential Trade-Through. These alerts occur via pop-up windows within PAR.

When Floor Brokers trade with Market-Makers the Market-Makers are not in as good of a position to prevent Trade-Throughs and book priority violations. Although Market-Makers have access to market data via screens on the trading floor and/or their own electronic devices, they do not have access to the specific terms and conditions of a Floor Broker's order on an electronic basis and must evaluate the CBOE BBO and the NBBO without the aid of PAR. Instead, a request for quote for a given order is verbally communicated by a Floor Broker to the trading crowd and the verbal information is taken into consideration by Market-Makers (and other in-crowd market participants) when providing a responsive quote. Furthermore, Market-Makers evaluate a Floor Broker's request for a quote against the Market-Maker's theoretical

values for the given options series. This process becomes even more complicated when there are multiple options series that must be evaluated for a complex order. Ultimately, the Exchange believes it is reasonable for a Market-Maker to rely on a Floor Broker to ensure that an open outcry transaction is executed in accordance with the priority and allocation provisions and Trade-Through prohibition provisions when the Floor Broker is initiating the transaction. If a Market-Maker initiates a transaction with a Floor Broker the Market-Maker will be responsible for ensuring that the transaction is executed in accordance with the priority and allocation provisions and Trade-Through prohibition provisions.

The Exchange proposes to add Interpretation and Policy .05 to Rule 6.45A, .06 to Rule 6.45B, and .07 to Rule 6.73. As previously noted, the proposal does not amend who is responsible when an open outcry transaction is between Floor Brokers or between Market-Makers. As is the case today, for open outcry transactions between Floor Brokers or open outcry transactions between Market-Makers, both parties are responsible for ensuring that a transaction is executed in accordance with the priority and allocation rules and the Trade-Through prevention rules. For these scenarios the proposal simply sets forth the existing standard, which, again, calls for both parties being responsible for ensuring that a transaction is executed in accordance with the priority and allocation rules and the Trade-Through prohibition rules.

The Exchange notes that this rule change, consistent with the Options Intermarket Linkage Plan, is reasonably designed to prevent Trade-Throughs<sup>6</sup> as well as book priority violations because the proposal places the responsibility for ensuring transactions are executed in accordance with the rules on the specific party or parties in a good position to ensure compliance. The Exchange also notes that this rule may help limit the number of priority and

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<sup>6</sup> See generally Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000) (Order approving Options Intermarket Linkage Plan).

Trade-Through violations because the proposal identifies a particular party or parties to each transaction (as opposed to all parties) as being responsible for ensuring compliance with the rules. Furthermore, in all cases the responsibility will fall on all parties to the transaction (i.e., when Floor Broker trades with another Floor Broker or when a Market-Maker trades with another Market-Maker) or the initiator of the transaction.

## 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>7</sup> Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>8</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 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>9</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 that the proposed rule change is appropriate because the vast majority of the time Floor Brokers are the initiators of open outcry transactions on the trading floor, and they are able to use PAR to assist them with ensuring that transactions are

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<sup>7</sup> 15 U.S.C. 78f(b).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

<sup>9</sup> Id.

executed in accordance with priority and allocation rules and Trade-Through prohibition rules, which makes this proposal reasonably designed to ensure compliance with Exchange Rules. As a result, the Exchange believes this change will remove potential impediments to a free and open market and a national market system. The Exchange also believes this rule change may help limit the number of priority and Trade-Through violations, which generally helps to protect investors and the public interest, because the proposal more appropriately identifies the specific party or parties responsible for ensuring compliance with these rules (i.e., the initiator in the case of Floor Brokers trading with Market-Makers and both parties when Market-Makers trade with Market-Makers and both parties when Floor Brokers trade with Floor Brokers). Furthermore, in all cases the responsibility will fall on all parties to the transaction (i.e., when Floor Broker trades with another Floor Broker or when a Market-Maker trades with another Market-Maker) or the initiator of the transaction.

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. CBOE does not believe that the proposed rule change will impose any burden on intramarket competition that is not necessary or appropriate in furtherance of the purposes of the Act because the proposed change will apply equally to all market participants that initiate transactions on the floor of the Exchange. Furthermore, any perceived burden on Floor Brokers or Market-Makers is misplaced because Floor Brokers and Market-makers are no worse off from this proposal as both parties are currently held responsible for book priority and trade-through violations. The Exchange does not believe that the proposed change will impose any burden on intermarket competition because it only applies to trading on CBOE.



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 up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange 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 Number SR-CBOE-2016-082 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-CBOE-2016-082. 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 the 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-CBOE-2016-082 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>10</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>10</sup> 17 CFR 200.30-3(a)(12).