SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-66760; File No. SR-C2-2012-004)

April 6, 2012

Self-Regulatory Organizations; C2 Options Exchange, Incorporated; Order Approving a Proposed
Rule Change Relating to Stock-Option Orders

I.   Introduction

 On February 7, 2012, the C2 Options Exchange, Incorporated ("Exchange" or "C2") 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 C2 Rule 6.13, "Complex Order Execution," to, among other things, revise C2's

procedures for electronically executing stock-option orders. The proposed rule change was

published for comment in the Federal Register on February 21, 2012.[3] The Commission

received no comment letters regarding the proposed rule change. This order approves the

proposed rule change.

II.   Description of the Proposal

        C2 proposes to amend C2 Rule 6.13 to adopt definitions of complex order and stock-

option order, and to provide procedures for electronically executing stock-option orders.

        A.   Definitions of Complex Order and Stock-Option Order

        C2 proposes to amend C2 Rule 6.13(a) to include definitions of complex order[4] and

stock-option order.[5] C2 notes that its new definitions of complex order and stock-option order

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[1]   15 U.S.C. 78s(b)(1).

[2]   17 CFR 240.19b-4.

[3]   Securities Exchange Act Release No. 66393 (February 14, 2012), 77 FR 10020
        ("Notice").

[4]   C2 proposes to define a complex order as any order involving the execution of two or
        more different options series in the same underlying security occurring at or near the

are consistent with those of another options exchange,[6] and with the definitions used in C2

Chapter VI, Section E, "Intermarket Linkage," which incorporates by reference Chicago Board

Options Exchange, Inc. ("CBOE") CBOE Rule 6.80(4).

C2 Rule 6.13(b)(2) currently permits only complex orders with no more than four legs to

be placed in the Complex Order Book ("COB"). C2 proposes to remove this limitation and to

provide that only complex orders and stock-option orders with no more than the applicable

number of legs, as determined by C2 on a class-by-class basis, will be eligible for processing.[7]

    B.   <u>Execution of Stock-Option Orders</u>

        1.   <u>Legging</u>

C2 proposes to add Interpretation and Policy .06 to Rule 6.13 to provide that stock-option

orders will execute against other stock-option orders through COB and the Complex Order RFR

Auction ("COA"). Stock-option orders will not be legged against the individual component legs,

except in one limited circumstance, as described below.[8] C2 believes that the proposal will

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same time in a ratio that is equal to or greater than one-to-three (.333) and less than or equal to three-to-one (3.00) (or such lower ratio as may be determined by the Exchange on a class-by-class basis) and for the purpose of executing a particular investment strategy. <u>See</u> C2 Rule 6.13(a)(1).

[5]   C2 proposes to define 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 ("convertible security") coupled with the purchase or sale of options contract(s) on the opposite side of the market representing either (i) the same number of units of the underlying stock or convertible security; or (ii) the number of units of the underlying stock necessary to create a delta neutral position, but in no case in a ratio greater than eight (8) options contracts per unit of trading of the underlying stock or convertible security established for that series by The Options Clearing Corporation (or such lower ratio as may be determined by the Exchange on a class-by-class basis). <u>See</u> C2 Rule 6.13(a)(2).

[6]   <u>See</u> ISE Rule 722(a)(1) and (2).

[7]   <u>See</u> C2 Rule 6.13(a)(1) and (2).

[8]   <u>See</u> C2 Rule 6.13, Interpretation and Policy .06(d).

provide for more efficient execution and processing of stock-option orders and will help to

mitigate the potential risks associated with legging stock-option orders, including the risk of an

unhedged position if one leg of the order cannot be executed.[9]

C2 proposes to permit legging for an eligible market stock-option order that cannot be

executed in full, or in a permissible ratio, at the conclusion of a COA.[10] At the conclusion of a

COA, any remaining balance of the option leg(s) of an eligible market stock-option order will

route to C2's system for processing as a simple market order(s), and C2 will electronically

transmit any remaining balance of the stock leg to a designated broker-dealer (as described

below) for processing as a market order.[11] The designated broker-dealer will represent the stock

leg on behalf of the party that submitted the stock-option order.

For purposes of this legging functionality, an eligible market order is a stock-option order

that is within certain parameters determined by C2 and for which the NBBO is within designated

size and price parameters, as determined by C2 for the individual leg.[12] The designated NBBO

price parameters will be determined based on a minimum bid price for sell orders.[13] The

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[9]   See Notice, 77 FR at 10021–22.

[10]   See C2 Rule 6.13, Interpretation and Policy .06(d). For purposes of the legging
       functionality, an eligible market order is a stock-option order that is within the designated
       size and order type parameters, as determined by C2 on a class-by-class basis, and for
       which the national best bid or offer ("NBBO") is within designated size and price
       parameters, as determined by C2 for the individual leg. See C2 Rule 6.13, Interpretation
       and Policy .06(d).

[11]   See C2 Rule 6.13, Interpretation and Policy .06(d).

[12]   See id.

[13]   See id.

Exchange may also determine on a class-by-class basis to limit the trading times within regular trading hours that the legging functionality will be available.[14]

C2 believes that the order eligibility parameters for eligible market stock-option orders will help to mitigate the potential risks associated with legging stock-option orders, including the risk of an order drilling through multiple price points on another exchange (thereby resulting in executions at prices that are far from the NBBO and potentially erroneous), and the risk that one leg of the stock-option order will go unexecuted (resulting in an incomplete execution and a partial position that is unhedged).[15]

2. Communication of Stock Leg to a Designated Broker-Dealer(s)

Under the proposal, C2 will electronically communicate the stock leg of a stock-option order to a designated broker-dealer(s) for execution on behalf of a Permit Holder.[16] C2 believes that this procedure will provide a more efficient means for processing stock-option orders.[17] To participate in stock-option order automated processing, a Permit Holder must enter into a brokerage agreement with one or more designated broker-dealers that are not affiliated with C2.[18]

C2 will transmit the stock component of a stock-option order to a designated broker-dealer as two paired orders with a designated limit price (except in the limited circumstance described above for eligible market stock-option orders) after the Exchange's trading system

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[14]   See id.

[15]   See Notice, 77 FR at 10022.

[16]   See C2 Rule 6.13, Interpretation and Policy .06(a).

[17]   See Notice, 77 FR at 10021.

[18]   See C2 Rule 6.13, Interpretation and Policy .06(a).

determines that a stock-option order trade is possible and at what net prices.[19] The designated

broker-dealer will act as agent for the stock leg of a stock-option order and will be responsible

for the proper execution, trade reporting, and submission to clearing of the stock trade.[20] After

C2 communicates the stock orders to the designated broker-dealer for execution, the designated

broker-dealer will be responsible for determining whether the orders may be executed in

accordance with all of the rules applicable to execution of equity orders, including compliance

with applicable short sale, trade-through, and trade reporting rules.[21] If the designated broker-

dealer cannot execute the stock leg at the designated price, the stock-option order will not be

executed on the Exchange.[22]

A Permit Holder may submit a stock-option order only if the order complies with the

qualified contingent trade exemption ("QCT Exemption") from Rule 611(a) of Regulation

NMS,[23] and a Permit Holder submitting a stock-option order represents that the order complies

with the QCT Exemption.[24] In addition, as described more fully in the Notice, C2's system will

validate compliance with the QCT Exemption with respect to each matched order communicated

to the designated broker-dealer.[25]

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[19]   See Notice, 77 FR at 10020.

[20]   See id. at 10020–21.

[21]   See id. at 10021.

[22]   See id. at 10021 and C2 Rule 6.13, Interpretation and Policy .06.

[23]   See 17 CFR 242.611(a). See also Securities Exchange Act Release No. 57620 (April 4, 2008), 73 FR 19271 (April 9, 2008) (order modifying the QCT Exemption) and Securities Exchange Act Release No. 53489 (August 31, 2006), 71 FR 52829 (September 7, 2006) (order establishing the QCT Exemption).

[24]   See C2 Rule 6.13, Interpretation and Policy .06(a).

[25]   See Notice, 77 FR at 10021.

C2 intends to file a separate proposal to establish fees related to the routing of the stock portion of a stock-option order.[26]

C. Allocation Algorithms and Priority

1. COB and COA Allocation Algorithms

Stock-option orders in COB and COA will execute according to an electronic allocation algorithm. Specifically, stock-option orders in COB that are marketable against each other will execute automatically.[27] Multiple stock-option orders at the same price will be allocated pursuant to the rules of trading priority otherwise applicable to incoming electronic orders in the individual component legs,[28] or pursuant to another allocation algorithm designated by C2 under C2 Rule 6.13, Interpretation and Policy .05.[29]

Stock-option orders executed against other stock-option orders through a COA will trade first at the best net price(s) and, at the same price, in the sequence set forth in C2 Rule 6.13(c)(5)(B)–(D).[30]

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[26]   See id. at 10021.

[27]   See C2 Rule 6.13, Interpretation and Policy .06(c).

[28]   See id. C2 notes that the allocation algorithms for the individual series legs include price-time, pro-rata, and price-time with primary public customer and secondary trade participation right priority and an optional priority overlay pertaining to market turner priority. See Notice, 77 FR at footnote 15. See also C2 Rule 6.12.

[29]   See C2 Rule 6.13, Interpretation and Policy .06(c). C2 Rule 6.13, Interpretation and Policy .05 allows C2 to determine, on a class-by-class basis, which electronic matching algorithm from Rule 6.12 will apply to executions in COB in lieu of the algorithm specified in C2 Rule 6.13(b)(1)(B).

[30]   See C2 Rule 6.13, Interpretation and Policy .06(d). Under Interpretation and Policy .06(d), a stock-option order that was subject to a COA would execute against other stock-option orders first at the same net price(s) and, at the same price, in the following sequence: (i) against public customer stock-option orders resting in COB before, or that are received during, the COA Response Time Interval, and public customer RFR responses, with multiple orders ranked by time priority; (ii) against non-public customer stock-option orders resting in the COB before the COA Response Time Interval, with

2.   Priority

For a stock-option order to execute against another stock-option order in COB or COA,

the execution must occur at a price where the option leg(s) of the stock-option order have priority

over the individual orders and quotes in C2's Book.[31] To satisfy this condition, the individual

option leg(s) of the stock-option order: (i) must not trade at a price that is inferior to C2's best

bid (offer) in the individual component series; and (ii) must not trade at C2's best bid (offer) in

the individual component series if one or more public customer orders are resting at the best bid

(offer) price in each of the component option series and the stock-option order could otherwise

be executed in full or in a permissible ratio.[32] The option leg(s) of a stock-option order may be

executed in a one-cent increment regardless of the minimum quoting increment applicable to that

series.[33]

D.   Provisions Applicable to Marketable Stock-Option Orders

Several provisions in the proposal address the handling of a stock-option order that is or

becomes marketable. First, to the extent that a marketable stock-option order cannot be executed

in full, or in a permissible ratio, when it is routed to COB or following a COA, any part of the

order that can execute will execute and the part that cannot automatically execute will be

cancelled.[34]

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multiple orders subject to the rules of trading priority otherwise applicable to incoming orders in the individual component legs; and (iii) against non-public customer stock-option orders resting in the COB that are received during the COA Response Time Interval and non-public customer responses, with multiple orders subject to the rules of trading priority otherwise applicable to incoming orders in the individual component legs.

[31]   See Notice, 77 FR at 10022.

[32]   See C2 Rule 6.13, Interpretation and Policy .06(b). See also Notice, 77 FR at 10022.

[33]   See C2 Rule 6.13, Interpretation and Policy .06(b).

[34]   See C2 Rule 6.13, Interpretation and Policy .06(b)(1).

Second, to the extent that a stock-option order resting in COB becomes marketable

against the derived net market, the full order will be subject to a COA.[35] The derived net market

for a strategy will be calculated using C2's best bid or offer in the individual option series leg(s)

and the NBBO in the stock leg.[36] After being subject to a COA, any part of the order that may

be executed will be executed automatically and the part that cannot execute automatically will be

canceled.[37] C2 believes that automatically initiating a COA after a resting stock-option order

becomes marketable against the derived net market will provide an opportunity for market

participants to match or improve the net price and provide an opportunity for automatic

execution of the order.[38] C2 notes that this system feature will not be applicable to a resting

stock-option order that becomes marketable against another stock-option order(s).[39]

E.   Price Check Parameters

C2 proposes to adopt a new price check parameter applicable to the electronic processing

of stock-option orders.[40] This new price check parameter will allow C2 to determine, on a class-

by-class basis, and announce via Regulatory Circular, not to automatically execute a stock-option

order if, following a COA, the execution would not be within the acceptable derived net market

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[35]   See C2 Rule 6.13, Interpretation and Policy .06(b)(2). The order would not execute
automatically against the derived net market because stock-option orders will not execute
against the individual legs of the order, except in the limited circumstance described
above.

[36]   See id.

[37]   See C2 Rule 6.13, Interpretation and Policy .06(b)(1). For examples of this proposed
functionality, see the Notice, 77 FR at 10023.

[38]   See Notice, 77 FR at 10022–23.

[39]   See id. at 10022.

[40]   See C2 Rule 6.13, Interpretation and Policy .04(f).

for the strategy that existed at the start of the COA.[41] A stock-option order that is not within the

acceptable derived net market will be cancelled.[42]

The "acceptable derived net market" for a strategy will be calculated using C2's best bid

or offer in the individual option series leg(s) and the NBBO in the stock leg plus/minus an

acceptable tick distance.[43] C2 will determine the "acceptable tick distance" on a class-by-class

basis.[44] C2 believes it is reasonable and appropriate to use the Exchange's best bid and offer for

the individual series to calculate the acceptable derived net market for the option series leg(s)

because the option component leg(s) of a stock-option order are not permitted to trade at a price

that is inferior to the Exchange's best bid and offer.[45] C2 believes it is reasonable and

appropriate to use the NBBO plus/minus an acceptable tick distance to calculate the acceptable

derived net market for the stock component because C2 believes the NBBO should serve as a

reasonable proxy for what may be considered a reasonable price for the automatic execution of

the stock component leg.[46] C2 believes, further, that it also may be appropriate to consider some

range outside the NBBO in determining the acceptable tick distance because the stock leg of a

stock-option order that qualifies for the QCT Exemption[47] may be executed outside the NBBO

for the stock.[48] Accordingly, in establishing the acceptable tick distance for the stock leg of the

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[41]   See id.

[42]   See C2 Rule 6.13, Interpretation and Policy .04(f)(2).

[43]   See C2 Rule 6.13, Interpretation and Policy .04(f)(1).

[44]   See id. For an example of how this price check parameter would operate, see the Notice, 77 FR at 10023.

[45]   See Notice, 77 FR at footnote 19.

[46]   See id.

[47]   See supra note 23.

[48]   See Notice, 77 FR at footnote 19.

order, C2 would have the flexibility to use the NBBO (which would equate to an acceptable tick distance of 0) or a range outside the NBBO.[49]

In classes where this price check parameter is available, it will also be available for COA responses under C2 Rule 6.13(c); Automated Improvement Mechanism ("AIM") and Solicitation Auction Mechanism stock-option orders and responses under C2 Rules 6.51 and 6.52; and AIM customer-to-customer immediate cross stock-option orders under C2 Rule 6.51, Interpretation and Policy .08.[50] Under these provisions, paired stock-option orders and responses will not be accepted, except that, to the extent only a paired contra-side order subject to an auction under C2 Rule 6.51 or C2 Rule 6.52 exceeds the price check parameter, the contra-side order will not be accepted and the paired original Agency Order will not be accepted or, at the order entry firm's discretion, continue processing as an unpaired stock-option order (e.g., the Agency Order would route to COB or COA for processing).[51] To the extent that a contra-side order or response is marketable, its price will be capped at the price inside the acceptable derived net market.[52]

C2 also proposes to apply the existing individual series leg width price check parameter in C2 Rule 6.13, Interpretation and Policy .04(a) to market and marketable limit stock-option orders.[53] Under this price check parameter, a market or marketable limit stock-option order in a class where the price check parameter is available will not be executed automatically if the width

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[49]   See id.

[50]   See C2 Rule 6.13, Interpretation and Policy .04(f).

[51]   See id.

[52]   See id. For an example of how this price check parameter would operate, see the Notice, 77 FR at 10024.

[53]   See C2 Rule 6.13, Interpretation and Policy .04(a)(5) and Notice, 77 FR at 10024.

between C2's best bid and best offer in any individual series leg is not within an acceptable price range.[54]

In addition, C2 proposes to apply the existing buy-buy (sell-sell) strategy price check parameter in C2 Rule 6.13, Interpretation and Policy .04(d) to stock-option orders.[55] Under this price check parameter, C2's system will not automatically execute a limit order where (1) all the components of the strategy are to buy and the order is priced at zero, any net credit price, or a net debit price that is less than the number of an individual option series leg in the strategy (or applicable ratio) multiplied by the applicable minimum net price increment for the complex order; or (2) all the components of the strategy are to sell and the order is priced at zero, any net debit price, or a net credit price that is less than the number of individual option series legs in the strategy (or applicable ratio) multiplied by the applicable minimum net price increment for the complex order.[56] Instead, such a stock-option order will not be accepted.[57]

C2 believes that the price protection parameters will help to mitigate the potential risks associated with stock-option orders drilling through multiple price points and with stock-option orders being entered at net limit prices that are inconsistent with the particular "buy-buy" or "sell-sell" strategy, thereby resulting in executions that are extreme and potentially erroneous.[58]

     F.   Extension of the re-COA Feature to Stock-Option Orders

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[54]   See C2 Rule 6.13, Interpretation and Policy .04(a).

[55]   See C2 Rule 6.13, Interpretation and Policy .04(d) and Notice, 77 FR at 10024.

[56]   See C2 Rule 6.13, Interpretation and Policy .04(d). The minimum net price increment calculation would only apply to the individual option series legs.

[57]   See id.

[58]   See Notice, 77 FR at 10024.

C2 Rule 6.13, Interpretation and Policy .02(b) provides that, for classes in which COA is activated, a non-marketable order resting at the top of the COB may be automatically subject to a COA if the order is within a number of ticks away from the current derived net market. C2 proposes to extend this "re-COA" feature to include stock-option orders resting at the top of the COB, and to provide that the derived net market for a stock-option order will be calculated using C2's best bid or offer in the individual option series leg(s) and the NBBO in the stock leg.[59] C2 notes that this feature would apply only to a resting non-marketable stock-option order that moves close to the derived net market, but would not apply to a resting stock-option order that becomes marketable against another stock-option order(s).[60] C2 believes that this re-COA feature will facilitate the execution of stock-option orders by providing an automated opportunity for the execution of, and price improvement to, a resting stock-option order that is priced near the current market, similar to what a Permit Holder might do if the Permit Holder were representing a stock-option order in open outcry on another exchange or entering the order into the COB.[61]

III.   Discussion and Commission's Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.[62] In particular, the Commission finds that the proposed rule change is

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[59]   See C2 Rule 6.13, Interpretation and Policy .02(b).

[60]   See Notice, 77 FR at 10024. For an example of how the re-COA feature would operate, see id. at 10025.

[61]   See id. at 10024–25.

[62]   In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

consistent with Section 6(b)(5) of the Act,[63] which requires, among other things, that the rules of

a national securities exchange be designed to prevent fraudulent and manipulative acts and

practices, to promote just and equitable principles of trade, 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.

A. Definitions of Complex Order and Stock-Option Order

The Commission finds that the proposed definitions of complex order and stock-option

order are consistent with the Act. The Commission notes that the proposed definitions of

complex order and stock-option order are consistent with definitions included in the rules of

another options exchange,[64] and in CBOE Rule 6.80(4), which is incorporated by reference in

C2's rules.[65] In addition, the Commission believes that the proposed rule change removing the

limit on the number of legs that may be included in a complex order could provide greater

flexibility and permit the electronic trading on C2 of additional complex orders.

B. Execution of Stock-Option Orders

1. Legging of Stock-Option Orders

The Commission believes that the proposal to add Interpretation and Policy .06 to Rule

6.13 to provide that stock-option orders will execute against other stock-option orders through

COB and COA is consistent with the Act because it could facilitate the execution of stock-option

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[63] 15 U.S.C. 78f(b)(5).

[64] See ISE Rule 722(a)(1) and (2).

[65] See C2 Chapter VI, Section E, "Intermarket Linkage" (incorporating the rules in CBOE Chapter VI, Section E). CBOE Rule 6.80(4) defines a Complex Trade for purposes of CBOE Chapter VI, Section E, "Order Protection; Locked and Crossed Markets." CBOE Rule 6.81(b)(7) provides an exception from the prohibition on Trade-Throughs for any transaction that was effected as a portion of a Complex Trade.

orders. The Commission notes that another options exchange similarly permits stock-option

orders traded on its electronic trading platform to execute only against other stock-option

orders.[66]

The Commission also believes that it is consistent with the Act for C2 to permit the

legging of eligible market stock-option orders that cannot be executed in full or in a permissible

ratio at the conclusion of COA because the legging functionality could provide an additional

opportunity for these orders to be executed. The Commission notes that C2 believes that the

eligibility parameters for eligible stock-option orders could help to mitigate the risks that may be

associated with legging stock-option orders.[67]

2. Communication of Stock Leg to a Designated Broker-Dealer(s)

As described more fully above, C2 proposes to allow the Exchange to electronically

communicate the stock leg of a stock-option order to a designated broker-dealer(s) for execution

on behalf of a Permit Holder.[68] To participate in stock-option order automated processing, a

Permit Holder must enter into a brokerage agreement with one or more designated broker-dealers

that are not affiliated with C2.[69]

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[66] See Phlx Rule 1080, Commentary .08(a)(i) (stating that stock-option orders may only be executed against other stock-option orders and cannot be executed by the system against orders for the individual components).

[67] See Notice, 77 FR at 10022. Under C2 Rule 6.13, Interpretation and Policy .06(d), an eligible market order means a stock-option order that is within the designated size and order type parameters, determined by the Exchange on a class-by-class basis, and for which the NBBO is within designated size and price parameters, as determined by the Exchange for the individual leg. The designated NBBO price parameters will be determined based on a minimum bid price for sell orders. The Exchange may also determine on a class-by-class basis to limit the trading times within regular trading hours that the legging functionality will be available.

[68] See C2 Rule 6.13, Interpretation and Policy .06(a).

[69] See id.

The designated broker-dealer will act as agent for the stock leg of a stock-option order and will be responsible for the proper execution, trade reporting, and submission to clearing of the stock trade.[70] In addition, after C2 communicates the paired stock orders to the designated broker-dealer for execution, the designated broker-dealer will be responsible for determining whether the orders may be executed in accordance with all of the rules applicable to the execution of equity orders, including compliance with applicable short sale, trade-through, and trade reporting rules.[71] A Permit Holder may submit a stock-option order only if the order complies with the QCT Exemption from Rule 611(a) of Regulation NMS, and a Permit Holder submitting a stock-option order represents that the order complies with the QCT Exemption.[72] As described more fully in the Notice, C2's system will validate compliance with the QCT Exemption with respect to each matched order communicated to the designated broker-dealer.[73]

C2's proposal to electronically communicate the stock leg of a stock-option order to a designated broker-dealer for execution is similar to rules adopted by other options exchanges.[74] Accordingly, the Commission finds that the proposal to allow C2 to electronically communicate the stock leg of a stock-option order to a designated broker-dealer that is not affiliated with C2 for execution on behalf of a Permit Holder is consistent with the Act.

C. Allocation Algorithms and Priority

1. COB and COA Allocation Algorithms

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[70] See Notice, 77 FR at 10020–21.

[71] See id. at 10021.

[72] See C2 Rule 6.13, Interpretation and Policy .06(a).

[73] See Notice, 77 FR at 10021.

[74] See ISE Rule 722, Supplementary Material .02. See also Phlx Rule 1080, Commentary .08.

Stock-option orders in COB that are marketable against each other will execute automatically, and multiple stock-option orders at the same price will be allocated pursuant to the rules of trading priority otherwise applicable to incoming electronic orders in the individual component legs.[75] The Commission notes that this allocation provision for stock-option orders in COB is consistent with the existing complex order allocation provision in C2 Rule 6.13(b)(1)(B).[76] Accordingly, the Commission believes that the allocation provision for marketable stock-option orders in COB is consistent with the Act.

Under the proposal, stock-option orders executed against other stock-option orders through a COA will trade first at the best net price(s) and, at the same price, in the sequence set forth in C2 Rule 6.13(c)(5)(B)–(D).[77] The allocation sequence in C2 Rule 6.13(c)(5)(A) – (D) currently applies to complex orders.[78] The Commission believes that it is consistent with the Act

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[75] See id.

[76] C2 Rule 6.13(b)(1)(B) states that the allocation of complex orders in COB will be pursuant to the rules to trading priority otherwise applicable to incoming electronic orders in the individual component legs.

[77] See C2 Rule 6.13, Interpretation and Policy .06(d). Under Interpretation and Policy .06(d), a stock-option order that was subject to a COA would execute against other stock-option orders first at the same net price(s) and, at the same price, in the following sequence: (i) against public customer stock-option orders resting in the COB before, or that are received during, the COA Response Time Interval and public customer RFR responses, with multiple orders ranked by time priority; (ii) against non-public customer stock-option orders resting in the COB before the COA Response Time Interval, with multiple orders subject to the rules of trading priority otherwise applicable to incoming orders in the individual component legs; and (iii) against non-public customer stock-option orders resting in the COB that are received during the COA Response Time Interval and non-public customer responses, with multiple orders subject to the rules of trading priority otherwise applicable to incoming orders in the individual component legs.

[78] Because C2 will not permit the legging of stock-option orders, except with respect to eligible market stock-option orders at the conclusion of a COA, the allocation algorithm for stock-option orders will not apply C2 Rule 6.13(c)(5)(A), which provides for the execution of a complex order against individual orders and quotes in the Book. See C2 Rule 6.13, Interpretation and Policy .06(d).

for C2 to apply this allocation sequence, as modified to reflect that stock-option orders will not execute against individual orders and quotes in the Book, to stock-option orders as well as complex orders.

2. Priority

For a stock-option order to execute against another stock-option order in COB or COA, the execution must occur at a price where the option leg(s) of the stock-option order have priority over the individual orders and quotes in C2's Book.[79] To satisfy this condition, the individual option leg(s) of the stock-option order: (i) must not trade at a price that is inferior to C2's best bid (offer) in the individual component series; and (ii) must not trade at C2's best bid (offer) in the individual component series if one or more public customer orders are resting at the best bid (offer) price in each of the component option series and the stock-option order could otherwise be executed in full or in a permissible ratio.[80] These provisions are consistent with the rules of other options exchanges.[81] Accordingly, the Commission believes that the priority requirements for stock-option orders in Rule 6.13, Interpretation and Policy .06(b) are consistent with the Act.

D. Provisions Applicable to Marketable Stock-Option Orders

To the extent that a marketable stock-option order cannot be executed in full or in a permissible ratio when it is routed to COB or following a COA, any part of the order that can execute will execute and the part that cannot automatically execute will be cancelled.[82] The Commission believes this provision is consistent with the Act because it describes the handling

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[79]   See Notice, 77 FR at 10022.

[80]   See C2 Rule 6.13, Interpretation and Policy .06(b). See also Notice, 77 FR at 10022.

[81]   See, e.g., ISE Rule 722(b)(2) and NYSE Amex Rule 980NY, Commentary .03(d).

[82]   See C2 Rule 6.13, Interpretation and Policy .06(b)(1).

of the remaining balance of a marketable stock-option order that cannot be executed in full or in a permissible ratio.

In addition, to the extent that a stock-option order resting in COB becomes marketable against the derived net market, the full order will be subject to a COA.[83] The Commission believes that this provision is consistent with the Act.

E.   Price Check Parameters

The stock-option derived net market price check parameter in C2 Rule 6.13, Interpretation and Policy .04(f) will prevent the automatic execution of a stock-option order following a COA if the execution would not be within the acceptable derived net market that existed at the start of the COA. The Commission believes that this price check parameter is consistent with the Act because it could help to prevent the automatic execution of stock-option orders at extreme or potentially erroneous prices. The Commission believes that it is reasonable to use C2's best bid and offer for the individual series legs to calculate the acceptable derived net market for the option leg(s) of a stock-option order because the option leg(s) would not be permitted to trade at a price that is inferior to CBOE's best bid or offer. The Commission believes that using the NBBO for the stock, plus or minus an acceptable tick distance, to determine the acceptable derived net market for the stock leg of a stock-option order will provide C2 with flexibility in setting this parameter. The Commission notes that a stock-option order submitted to C2's system must comply with the QCT Exemption.[84] The stock leg of a stock-

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[83]   See C2 Rule 6.13, Interpretation and Policy .06(b)(2). This system feature will not be applicable to a resting stock-option order that becomes marketable against another stock-option order(s).

[84]   See C2 Rule 6.13, Interpretation and Policy .06(a).

option order that complies with the QCT Exemption would be permitted to trade at a price that is outside the NBBO for the stock.

C2 also proposes to extend the existing individual series leg width price check parameter in C2 Rule 6.13, Interpretation and Policy .04(a) to the individual series legs of market and marketable limit stock-option orders.[85] This price check parameter prevents the automatic execution of a marketable complex order when the width between C2's best bid and offer in any individual series leg is not within an acceptable price range. C2 further proposes to extend the existing buy-buy (sell-sell) strategy price check parameter in C2 Rule 6.13, Interpretation and Policy .04(d) to stock-option orders.[86] As described more fully above, this price check parameter prevents the automatic execution of complex order at a net limit price that is inconsistent with the order's strategy (e.g., an order where all of the components of a strategy are to buy, but the order is priced at 0 or at a net credit). The Commission believes it is consistent with the Act for C2 to have the ability to apply these price check parameters to stock-option orders, in addition to complex orders.

F.   Extension of the re-COA Feature to Stock-Option Orders

C2 proposes to amend C2 Rule 6.13, Interpretation and Policy .02(b) to apply its "re-COA" feature to stock-option orders resting at the top of the COB. For classes in which COA is activated, a non-marketable stock-option order resting at the top of the COB may be automatically subject to a COA if the order is within a number of ticks away from the current derived net market.[87] The Commission believes applying the "re-COA" feature to stock-option

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[85]   See C2 Rule 6.13, Interpretation and Policy .04(a)(5) and Notice, 77 FR at 10024.

[86]   See C2 Rule 6.13, Interpretation and Policy .04(d) and Notice, 77 FR at 10024.

[87]   See C2 Rule 6.13, Interpretation and Policy .02(b).

orders could facilitate the execution of stock-option orders by providing an opportunity for a stock-option order resting at the top of the COB to be executed automatically. Accordingly, the Commission finds that the provision is consistent with the Act.

IV.   Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[88] that the proposed rule change (SR-C2-2012-004) is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[89]

Kevin M. O'Neill
Deputy Secretary

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[88]   15 U.S.C. 78s(b)(2).

[89]   17 CFR 200.30-3(a)(12).