SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68792; File No. SR-C2-2013-004)

January 31, 2013

Self-Regulatory Organizations; C2 Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Amend the Fees Schedule

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),[1] and Rule

19b-4 thereunder,[2] notice is hereby given that on January 24, 2013, C2 Options Exchange,

Incorporated (the "Exchange" or "C2") filed with the Securities and Exchange Commission (the

"Commission") the proposed rule change as described in Items I, II, and III below, which Items

have been prepared by the Exchange. 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 amend the Fees Schedule. The text of the proposed rule

change is available on the Exchange's website (http://www.c2exchange.com/Legal/), 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.

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

[2]   17 CFR 240.19b-4.

A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend its transaction fees for simple, non-complex orders in equity options classes (all of which may be listed on other exchanges as well as C2). Going forward, fees will be calculated based on the following formula (fees are calculated on a per-contract basis):

Fee = (C2 BBO Market Width at time of execution) x (Market Participant Rate) x 50.

The C2 BBO Market Width is the difference between the quoted best offer and best bid in each class on C2 (the displayed C2 ask price minus the displayed C2 bid price). The Market Participant Rates are different rates for different types of market participants, as follows:

Market Participant	Rate
C2 Market-Maker	30%
Public Customer (Maker)	40%
All other origins	50%

The Exchange multiplies the C2 BBO Market Width and the Market Participant Rate by 50 because this allows C2 to reach a per-contract amount that takes into account half of the C2 BBO Market Width. The use of 50 as a multiplier is mathematically equivalent to the nominal C2 BBO Market Width divided by two, academically making the assumption that the theoretical value of the difference between the ask price and the bid price is the midpoint between the two. For purposes of this fee structure, the Exchange will be using the BBO as calculated by C2. The fee does not apply to Public Customer Takers because they will be receiving a rebate for such transactions (to be described later in this proposed rule change).

The Exchange uses different Market Participant Rates for different market participants as a function of each market participant's obligations and responsibilities in the relevant class, as well as

to provide incentives for Market-Makers to quote in a manner that narrows bid-ask spreads, which promotes market liquidity and therefore enhances market quality. C2 Market-Makers purchase permits and have quoting obligations, thereby justifying a lower Market Participant Rate. Public Customers have a lower Market Participant Rate than orders originating from other origins (other than C2 Market-Makers) because Public Customer order flow is a desirable commodity for all options exchanges and the Exchange seeks to attract such order flow. Further, Public Customers do not have access to many of the resources (such as technology, capital treatment, etc.) that other market participants may more easily access. Moreover, assessing different fee rates to different types of market participants is a common practice within the options industry, and many options exchanges, including C2, currently do so.[3]

The maximum fee for simple, non-complex orders in all equity options classes will be $0.85 per contract because, notwithstanding the tenets of the overall proposal, the Exchange does not want to have fees and rebates match or exceed the minimum trading increment ($0.01 x the 100 multiplier, or $1.00 per contract). This maximum fee amount is reasonable because, among other things, the fee will not always be assessed for the maximum amount. The fee will only be for the maximum amount when the BBO Market Width is wide. Otherwise, the fee will be smaller. Indeed, the purpose of the proposed new fees structure is to encourage tighter quoting by linking lower fees to such tighter quoting. A maximum fee amount is necessary to prevent fees from becoming prohibitively high in the event of a wide BBO Market Width. A maximum fee amount of $0.85 per

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[3]   See current C2 Fees Schedule, Section 1, which lists lower transaction fees for Public Customers than other market participants. See also Chicago Board Options Exchange, Incorporated ("CBOE") Fees Schedule, Rate Tables on pages 1-2, which list lower transaction fees for Customers and CBOE Market-Makers than other market participants. See also International Securities Exchange, LLC ("ISE") Schedule of Fees, Section 1, which lists lower transaction fees for Customers and ISE Market-Makers than other market participants.

contract is reasonable because it is lower than the minimum trading increment. The Commission

has, in the past, noted the argument that a maximum fee of $0.99 per contract or lower may be

viable because any maximum fee of $0.99 per contract or lower still allows for price improvement.[4]

Purchasing an options contract at $2.00 with an execution fee of $0.99 is a better all-inclusive price

than purchasing the same options contract at $2.01 with no execution fees. Simply put, the

execution of an order at a $0.01 better price will bring a better all-inclusive price as long as the fee

is $0.99 per contract or lower. The proposed maximum fee here is not even $0.99 per contract, but

only $0.85 per contract. And, as stated above, $0.85 will not be assessed on all transactions, but is

merely a maximum fee amount based on the formula described above for determining fees under

the proposed fees structure. Indeed, the Exchange anticipates that the vast majority of transactions

will be assessed a significantly lower per-contract fee than $0.85.

In conjunction with this new fee calculation for simple, non-complex orders in all equity

options classes, the Exchange proposes to adopt a rebate (in lieu of a fee) for simple, non-complex

Public Customer orders in all equity options classes that remove liquidity (i.e. takers) based upon

the following formula (rebates are calculated on a per-contract basis):

Rebate = (C2 BBO Market Width at time of execution) x (Order Size Multiplier) x 50

The Order Size Multiplier is a different multiplier based upon the size of the order:

Number of contracts in order	Multiplier
1-10	36%
11-99	30%
100-250	20%
251+	0%

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[4]   See Securities Exchange Act Release No. 61902 (April 14, 2010), 75 FR 20738 (April 20, 2010) (File No. S7-09-10) at 20750 ("It could be argued that because investors will not be worse off accessing a price that is better by $1 per contract as long as the fee to access that quotation is not more than $0.99 per contract, any fee cap should not be lower than $0.99 per contract…").

The rebate is limited to Public Customer taker orders because, at this time, C2 seeks to provide extra incentives for Public Customer order flow to route to the Exchange. Further, providing rebates targeted towards Public Customers is a common practice within the options industry, and many options exchanges, including C2, currently do so.[5] The Exchange applies different Order Size Multipliers for different size orders because the Exchange desires to attract smaller orders, and on related note, because of different hedging considerations associated with these smaller orders. Smaller orders are more attractive to Market-Makers because they are easier to hedge than large orders. For example, imagine a situation in which a Public Customer executes a 5-contract trade of at-the-money calls against a counterparty. In a practical delta hedge, the counterparty would execute a stock trade for 250 shares of the underlying stock (5 contracts X 50 delta). In contemporary stock markets, this size share block is relatively easy to execute. Had the transaction been for 500 contracts, the counterparty would have had to trade 25,000 shares of the underlying stock, which would be much more difficult. C2 will be most able to incent counterparties to participate in trades if they have a reasonable assumption that a meaningful amount of incoming orders will be for smaller quantities. This can be achieved by incentivizing order flow providers to direct small Public Customer "taker" orders to C2.

The proposed maximum rebate will be $0.75 per contract for the same reasons described above for limiting the maximum per-contract fee. It is necessary to maintain a spread between the maximum fee of $0.85 per contract and the maximum rebate, because, in the event that the maximum fee and rebate both apply, the $0.10 per-contract difference will allow the Exchange to

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[5]   See current C2 Fees Schedule, Section 1, and NASDAQ Stock Market LLC Options
       Market ("NOM") Chapter XV (Options Pricing), Section 2.

maintain a minimum level of profit potential. Rebate amounts are often generally lower than fee amounts on the Exchange, as well as on other exchanges,[6] for this reason (among others).

With respect to the rebate, in order to prevent order flow providers from "shredding" large Public Customer orders into smaller orders in order to take advantage of the higher rebates offered to such smaller Public Customer taker orders, multiple orders from the same executing firm for itself or for a Clearing Member Trading Agreement ("CMTA") or correspondent firm in the same series on the same side of the market that are received by the Exchange within 500 milliseconds will be aggregated for purposes of determining the order quantity. 500 milliseconds is the proper amount of time to discourage shredding to take advantage of quantity-based fees. Such a time interval is lengthy enough to discourage "shredding" due to the market risk the sender would realize in trying to game this interval. This time interval also matches that used by the Chicago Board Options Exchange, Incorporated ("CBOE") to prevent "shredding."[7]

To illustrate how the new fee and rebate structure would operate, consider the following examples. First, consider a situation in which the C2 market in an equity options class is 1.00 – 1.03, with the offer comprised of a resting C2 Market-Maker quote to sell 10 contracts. A Public Customer order to buy 10 contracts comes in and executes against that C2 Market-Maker quote at 1.03. At the time of the execution, the BBO Market Width is 0.03 (the difference between the C2 offer and the C2 bid). The fee for the C2 Market-Maker would be calculated by multiplying 0.03 by 30% (the Market Participant Rate for C2 Market-Makers), and then multiplying that by 50. As such, the fee for the C2 Market-Maker would be $0.45 per contract. Because the Public Customer order is a "taker" order, the Public Customer would receive a rebate. This rebate would be calculated by

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[6]   See current C2 Fees Schedule, Section 1, and NOM Chapter XV (Options Pricing), Section 2.

[7]   See CBOE Fees Schedule Table on "Linkage Fees".

multiplying the BBO Market Width of 0.03 by the Order Size Multiplier of 36% (because the Public Customer order is for 10 contracts), and then multiplying that by 50. As such, the Public Customer would receive a rebate of $0.54 per contract.

Now, consider a situation in which the C2 market in an equity options class is 3.50 – 3.52. The resting offer on the C2 Book is a C2 Market-Maker quote for 10 contracts, and next on the C2 Book sits a broker-dealer sell order at the same price for 15 contracts. Following that is a C2 Market-Maker quote for 25 contracts at 3.53 and a broker-dealer order for 20 contracts at 3.55. The best offer on another exchange is 3.54 for 25 contracts. A Public Customer ("taker") market order to buy 60 contracts at the market is received by C2.

The Public Customer buy order would trade with all interest at 3.52. The BBO Market Width here is 0.02. Therefore, the fees for execution of the C2 Market-Maker quote resting at 3.52 and the broker-dealer behind the C2 Market-Maker (but also at 3.52) would be calculated by multiplying 0.02 by the Market Participant Rate, which for a C2 Market-Maker is 30% and for a broker-dealer is 50%, and then multiplying each of those amounts by 50. The C2 Market-Maker sell quote's execution fee for those first 10 contracts would therefore be $0.30 per contract (0.02 x 30% x 50), and the broker-dealer sell order's fee for the next 15 contracts would be $0.50 per contract (0.02 x 50% x 50). The rebate for the Public Customer buy order would be calculated by multiplying the BBO Market Width (0.02) by the Order Size Multiplier (30%, because the size of the total order sent in by the Public Customer was 60 contracts), and then multiplying that amount by 50. Therefore, the Public Customer rebate would be $0.30 per contract for these first 25 contracts that traded at 3.52.

With 35 contracts remaining in the Public Customer buy order, it would then interact with the resting C2 Market-Maker quote to sell 25 contracts at 3.53. The fee for execution of this C2

Market-Maker quote would be calculated by multiplying the new BBO Market Width (now 0.03) by the C2 Market-Maker Market Participant Rate of 30%, and then multiplying that amount by 50. Therefore, the C2 Market-Maker's fee for these 25 contracts would be $0.45 per contract. The rebate for the Public Customer buy order (for these next 25 contracts) would be calculated by multiplying this new BBO Market Width of 0.03 by the Order Size Multiplier of 30%, and then multiplying that by 50. Therefore, the Public Customer rebate for these 25 contracts would be $0.45 per contracts.

There remain 10 contracts on Public Customer's buy order. However, because another exchange is now quoting a resting order for 25 contracts at 3.54, and this quote is now the National Best Offer, the remaining 10 contracts on the buy order would be routed to that exchange rather than trading with the resting broker-dealer order on the C2 Book that is priced at 3.55.

Finally, consider a situation in which the C2 market in an equity options class is 1.00 – 1.05. A C2 Market-Maker quote to buy 5 contracts for at 1.00 sits on the C2 Book, with a broker-dealer order to buy another 5 contracts at the same price resting behind it. A Public Customer ("taker") order to sell 10 contracts at the market comes in and executes against the C2 Market-Maker quote and the broker-dealer buy order. The fee for the C2 Market-Maker would be calculated by multiplying the BBO Market Width of .05 by the C2 Market-Maker Market Participant Rate of 30%, and then multiplying that by 50. The fee for the C2 Market-Maker would be $0.75 per contract. The fee for the broker-dealer would be calculated by multiplying the BBO Market Width of .05 by the broker-dealer Market Participant Rate of 50%, and then multiplying that by 50. This comes out to $1.25 per contract. However, because this amount is higher than the maximum per-contract fee of $0.85 per contract, the broker-dealer's fee would be brought down to $0.85 per contract. The Public Customer's rebate would be calculated by multiplying the BBO Market Width

of 0.05 by the Order Size Multiplier of 36% (since the order is for 10 contracts) and then multiplying that by 50. This comes out to $0.90 per contract. However, because this amount is higher than the maximum per-contract rebate of $0.75 per contract, the Public Customer's rebate would be $0.75 per contract.

As with the current fee structure, there will be no fees or rebates for trades on the open. Because orders would have been received before the Exchange was disseminating a market, it would not be appropriate to assess fees (or provide rebates) based on an unknown BBO Market Width.

The Exchange proposes to adopt this new method of calculating fees and rebates because BBO Market Width is an important component of market quality and of the cost of using an exchange market. In addition, the structure of the Market Participant Rate, which is a component of the proposed fees structure, is designed to provide incentives for Market-Makers to quote in a manner that narrows bid-ask spreads, promotes market liquidity, and enhances market quality. Moreover, C2 believes that the proposed fee and rebate structure addresses issues with respect to maker-taker pricing that have been identified in academic studies. These studies find that although maker-taker pricing has led to a reduction in quoted spreads, it has not led to a decline in true economic spreads once access fees and liquidity rebates are accounted for.[8] C2 believes that, calibrated correctly, a fee formula for transaction fees and rebates based on BBO Market Width, Market Participant Rate, and order size harnesses the incentives of different market participants that leads them to behave in a way that narrows bid-ask spreads, promotes market liquidity, and thereby enhances overall market quality. C2 believes that its competitive position for order flow relative to

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[8]   See James Angel, Lawrence Harris, and Chester S. Spatt, "Equity Trading in the 21st Century," USC Marshall School of Business, May 18, 2010, page 42. See also Katya Malinova and Andreas Park, "Subsidizing Liquidity: The Impact of Make/Take Fees on Market Quality," available at: http://ssrn.com/abstract=1823600.

other option exchanges is improved through rules and policies that help promote high-quality markets.

The proposed new fee and rebate structure will potentially compliment brokers' best-execution obligations towards their customers. First, the proposed fee structure provides a generous "taker" rebate for public customers. The concept of "best execution" is primarily geared towards the treatment of retail order flow by brokers, and, on C2, the majority of public retail customer orders take liquidity, as opposed to make liquidity. Further, the amount of the fee or rebate for a transaction is easily determinable by applying the simple formulas described above. Order routers and other market participants have complex options pricing and routing software that should easily handle C2's proposed formula for fees or rebates. Moreover, even if it were difficult for brokers to determine the fee amounts, they could always assume the fee would equal the $0.85 per contract cap and route orders accordingly (even though the Exchange expects that fees for most transactions will fall short of that cap). Importantly, the $0.85 per contract cap is less than $1.00 per contract, which means that, in any situation in which C2 had even a one-cent better price than any other exchange, a market participant will be getting the best all-inclusive price by routing an order to C2. In situations in which C2 as well as another exchange(s) is at the NBBO, the market participant or order router can determine the exchange to which to send the order; there are multiple factors along with fees, including systems speed, service, etc., that are taken into account to determine "best execution", and since trade-throughs are of course prevented, the market participant will still be getting the best price. Finally, it will not be difficult to verify the BBO Market Width at the time of execution, as it could be deduced from the fee (which will be listed on the market participant's billing reports). Additionally, the

Exchange is currently developing the system functionality to list the BBO Market Width at the time of execution on the trade fill report.

The proposed new fee and rebate structure will benefit all market participants and the markets in general. A fee structure that is based upon BBO Market Width, in which fees are lower when such BBO Market Width is smaller, will encourage tighter quoting (which in turn means better prices). The rebates for Public Customers will bring greater Public Customer order flow to the Exchange, and this increased volume and liquidity will benefit all market participants. On a broader level, a new, original, different fee structure benefits investors and the market in general by providing a new and different option for investors to consider when they decide which exchange provides the most attractive option for directing order flow.

The proposed changes are to take effect on February 1, 2013.

2.   Statutory Basis

The Exchange believes the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to the Exchange and, in particular, the requirements of Section 6(b) of the Act.[9]   Specifically, the Exchange believes the proposed rule change is consistent with Section 6(b)(4) of the Act[10], which provides that Exchange rules may provide for the equitable allocation of reasonable dues, fees, and other charges among its Trading Permit Holders and other persons using its facilities. The proposed fee formula for simple, non-complex orders in all equity options classes is reasonable because it takes into account BBO Market Width, which is a factor in determining the liquidity associated with any potential options trade. Offering a different fee based on BBO Market Width is equitable and not unfairly discriminatory because

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[9]   15 U.S.C. 78f(b).

[10]   15 U.S.C. 78f(b)(4).

assessing a lower fee for narrower spreads will provide incentives to quote more narrowly, which thereby results in better prices for all market participants.

Offering a lower Market Participant Rate for C2 Market-Makers than for other market participants is equitable and not unfairly discriminatory because C2 Market-Makers take on a number of obligations, including quoting obligations and the need to purchase permits, that some other market participants do not have. Further, a fees structure that includes a lower Market Participant Rate for C2 Market-Makers, who are the market participants that do the vast majority of quoting, incentivizes more and narrower quoting, thereby encouraging liquidity provision, which is vital to the marketplace and benefits all market participants. Offering a lower Market Participant Rate for Public Customers than for orders originating from other market participants (except C2 Market-Makers) is equitable and not unfairly discriminatory because those other market participants do not have the obligations of C2 Market-Makers yet have access to many of the resources (technology, capital treatment, etc.) that Public Customers do not.

Not assessing fees or providing rebates for trades on the open is reasonable because it allows market participants to avoid having to pay fees for such trades. This is equitable and not unfairly discriminatory because orders would have been received before the Exchange was disseminating a market, and therefore it would not be appropriate to assess fees (or provide rebates) based on an unknown BBO Market Width.

In the past, in the context of market data fees, the Commission has acknowledged that exchanges can offer different prices to "particular classes of subscribers" based on market conditions such as "their economic circumstances and their need for and use of" a particular product or service.[11] For example, the Commission has previously approved or cited favorably to

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[11] See Securities Exchange Act No. 42208 (December 9, 1999), 64 FR 70613 (December

differential pricing between retail and non-retail investors.[12] Further, assessing different fee rates to different types of market participants is a common practice within the options industry, and many options exchanges, including C2, currently do so.[13] Far from undermining the purposes of the Exchange Act, the Commission has found that such differential pricing "provide[s] an opportunity for many investors to have access to" products and services that they otherwise might choose to forego.[14] Indeed, in the past, the Commission has disapproved fees when such fees would interfere with the operation of the national market system—for example, by providing market participants with quicker access to "top of book" data that broker dealers are required by law to access pursuant to their duty of best execution.[15] The current proposal does not present any such concerns.

Having a maximum per-contract fee amount under the proposed new formula is reasonable because it will limit the amount that market participants can pay. This maximum fee amount is

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17, 1999) at 70630 (Concept Release, Regulation of Market Information Fees and Revenues) (File No. S7-28-99).

[12] See id. at 70630-31; see also Securities Exchange Act Release No. 46843 (November 18, 2002), 67 FR 70471 (November 22, 2002) at 70472 (Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 5 to the Proposed Rule Change by the National Association of Securities Dealers, Inc., Relating to Fees for Nasdaq Data Entitlement Packages) (SR-NASD-2002-33).

[13] See current C2 Fees Schedule, Section 1, which lists lower transaction fees for Public Customers than other market participants. See also CBOE Fees Schedule, Rate Tables on pages 1-2, which list lower transaction fees for Customers and CBOE Market-Makers than other market participants. See also ISE Schedule of Fees, Section 1, which lists lower transaction fees for Customers and ISE Market-Makers than other market participants.

[14] See Securities Exchange Act Release No. 46843 (November 18, 2002), 67 FR 70471 (November 22, 2002) at 70472 (Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 5 to the Proposed Rule Change by the National Association of Securities Dealers, Inc., Relating to Fees for Nasdaq Data Entitlement Packages) (SR-NASD-2002-33).

[15] See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) at 37569 (Final Rules and Amendments to Joint Industry Plans ("Regulation NMS")) (File No. S7-10-04).

reasonable because the fee will not always be for the maximum amount. The fee will only be for the maximum amount when the BBO Market Width is wide. Otherwise, the fee will be smaller. Indeed, the purpose of the proposed new fees structure is to encourage tighter quoting by linking lower fees to such tighter quoting. A maximum fee amount is necessary to prevent fees from becoming prohibitively high in the event of a wide BBO Market Width. A maximum fee amount of $0.85 per contract is reasonable because it is lower than the minimum trading increment. The Commission has, in the past, noted the argument that a maximum fee of $0.99 per contract or lower may be viable because any maximum fee of $0.99 per contract or lower still allows for price improvement.[16] Purchasing an options contract at $2.00 with an execution fee of $0.99 is a better all-inclusive price than purchasing the same options contract at $2.01 with no execution fees. Simply put, the execution of an order at a $0.01 better price will bring a better all-inclusive price as long as the fee is $0.99 per contract or lower. The proposed maximum fee here is not even $0.99 per contract, but only $0.85 per contract. And, as stated above, $0.85 will not be assessed on all transactions, but is merely a maximum fee amount based on the formula described above for determining fees under the proposed fees structure. The maximum per-contract fee is equitable and not unfairly discriminatory because this limit will apply to all market participants.

Providing a rebate for Public Customer orders in all equity options classes that remove liquidity (i.e. takers) is reasonable because it will allow Public Customer takers to receive a rebate, as opposed to pay a fee, for the execution of orders. Providing this rebate to Public Customer takers only is equitable and not unfairly discriminatory because the increased volume

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[16]   See Securities Exchange Act Release No. 61902 (April 14, 2010), 75 FR 20738 (April 20, 2010) (File No. S7-09-10) at 20750 ("It could be argued that because investors will not be worse off accessing a price that is better by $1 per contract as long as the fee to access that quotation is not more than $0.99 per contract, any fee cap should not be lower than $0.99 per contract…").

and liquidity that the rebate will incentivize will benefit all other market participants. The rebate for "take" orders will incentivize Public Customers to "take" orders from all market participants, thereby providing a counterparty for resting "make" orders from all market participants. Further, providing rebates targeted towards Public Customers is a common practice within the options industry.[17]

Offering different Order Size Multipliers for different-sized orders is equitable and not unfairly discriminatory because the highest profit opportunity exists for the lowest-size orders since the profit potential is not captured until after the counter-party has executed its hedging transaction. Smaller orders are much easier to hedge than large orders, which makes smaller orders more attractive to Market-Makers. C2 will be most able to incent counterparties to participate in trades if they have a reasonable assumption that a meaningful amount of incoming orders will be for smaller quantities. This can be achieved by incentivizing order flow providers to direct small Public Customer "taker" orders to C2. This will benefit all market participants with the improved liquidity and trading opportunities. Market-Makers, who have greater obligations (including quoting), will be able to engage in more trades (especially hedging) due to the incenting of the direction of small Public Customer "taker" orders to C2.

Having a maximum rebate of $0.75 is reasonable because it is necessary to maintain a spread between the maximum fee of $0.85 per contract and the maximum rebate in order for the Exchange to maintain a minimum level of profit potential, and the $0.10 per contract difference allows the Exchange to do so. Currently, rebates are lower than fee amounts on the Exchange, as well as on other exchanges, for this reason. Moreover, the amount of the maximum rebate is higher

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[17]   See current C2 Fees Schedule, Section 1, and NOM Chapter XV (Options Pricing), Section 2.

than the maximum rebate currently offered on the Exchange[18] and is either higher than or within

the range of rebates offered on other exchanges.[19] The maximum rebate is equitable and not

unfairly discriminatory because it will be applied to all Public Customers equally. Further,

providing this rebate to Public Customer takers only is equitable and not unfairly discriminatory

because the increased volume and liquidity that the rebate will incentivize will benefit all other

market participants. The rebate for "take" orders will incentivize Public Customers to "take"

orders from all market participants, thereby providing a counterparty for resting "make" orders

from all market participants. Further, providing rebates targeted towards Public Customers is a

common practice within the options industry.[20]

Aggregating, for the purposes of determining the order quantity, multiple orders from the

same executing firm for itself or for a CMTA or correspondent firm in the same series on the

same side of the market that are received by the Exchange within 500 milliseconds is consistent

with the Section 6(b)(5)[21] requirements that the rules of an exchange be designed to promote just

and equitable principles of trade, to prevent fraudulent and manipulative acts, to remove

impediments to and to perfect the mechanism for a free and open market and a national market

system, and, in general, to protect investors and the public interest by preventing the "shredding"

of large orders into multiple smaller ones in order to accrue a larger rebate. 500 milliseconds is

the proper amount of time to discourage shredding to take advantage of quantity-based fees.

Such a time interval is lengthy enough to discourage "shredding" due to the market risk the

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[18]   <u>See</u> Exchange Fees Schedule, Section 1.

[19]   <u>See</u> <u>and</u> NOM Chapter XV (Options Pricing), Section 2.

[20]   <u>See</u> current C2 Fees Schedule, Section 1, <u>and</u> NOM Chapter XV (Options Pricing), Section 2.

[21]   15 U.S.C. 78f(b)(5).

sender would realize in trying to game this interval. This time interval also matches that used by CBOE to prevent "shredding."[22]

Finally, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)[23] requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, to remove impediments to and to perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest. Offering the proposed fee structure based on BBO Market Width provides a new and different option for investors looking to determine to which exchange to route orders, one that encourages tighter quoting and better prices, all of which perfects the mechanism for a free and open market and national market system.

Given the robust competition for order flow that exists in the options market, new, innovative price schedules like the one being proposed here are consistent with the above-mentioned goals of the Exchange Act. Indeed, by and large, the Commission historically has permitted exchanges to set their own fees absent some evidence that market forces were insufficient to constrain prices. There is no such evidence here.

When Congress charged the Commission with supervising the development of a "national market system" for securities, a premise of its action was that prices ordinarily would be determined by market forces. See, e.g., H.R. Rep. No. 94-229, at 92 (1975) (Conf. Rep.) (stating Congress's intent that the "national market system evolve through the interplay of competitive forces as unnecessary regulatory restrictions are removed"). Consistent with this purpose, Congress and the Commission have repeatedly stated their preference for competition, rather than regulatory intervention, to determine prices, products, and services in the securities

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[22]   See CBOE Fees Schedule Table on "Linkage Fees".

[23]   15 U.S.C. 78f(b)(5).

markets. See S. Rep. No. 94-75, 94th Cong., 1st Sess. 8 (1975) ("The objective [in enacting the 1975 amendments to the Exchange Act] would be to enhance competition and to allow economic forces, interacting within a fair regulatory field, to arrive at appropriate variations in practices and services."); Order Approving Proposed Rule Change Relating to NYSE Arca Data, Securities Exchange Act Release No. 59039 (December 2, 2008), 73 FR 74770 (Dec. 9, 2008) at 74781 ("The Exchange Act and its legislative history strongly support the Commission's reliance on competition, whenever possible, in meeting its regulatory responsibilities for overseeing the SROs and the national market system. Indeed, competition among multiple markets and market participants trading the same products is the hallmark of the national market system.") (SR-NYSEArca-2006-21); Regulation NMS, 70 FR at 37499 (observing that NMS regulation "has been remarkably successful in promoting market competition in [the] forms that are most important to investors and listed companies").

In NetCoalition v. Securities and Exchange Commission, 615 F.3d 525 (D.C. Cir. 2010), the D.C. Circuit approved the Commission's practice of relying on "competitive forces" in determining whether an exchange's proposed data fees were consistent with the purposes of the Exchange Act—as long as it had a "reasoned basis" for doing so. Id. at 544. Around the same time, Congress reaffirmed the primary role that exchanges have in setting prices when it enacted the Dodd-Frank amendments to the Exchange Act, which expanded the authorization of exchanges to file immediately effective fee schedules, subject only to limited post-effectiveness review by the Commission. 15 U.S.C. § 78s(b)(3)(A).

This consistent and considered judgment of Congress and the Commission is correct, particularly in light of evidence of robust competition in the options market for orders and liquidity. There are more options exchanges now than ever before, with no single exchange

commanding at a given time more than 35% of listed options market share, a very different picture than 10 or 20 years ago. As the Commission recently estimated, order volume is fairly evenly distributed between the four largest entities that own options exchanges.[24] Indeed, recent data demonstrates this distribution of market share: The CBOE Holdings entities (CBOE and C2) have combined a market share of 26.40%, the International Securities Exchange has a market share of 15.85%, the NYSE Euronext entities (NYSE Amex and NYSE Arca) have a combined market share of 25.59%, and The NASDAQ OMX Group, Inc. entities (NASDAQ OMX BX, NASDAQ OMX Phlx, and NASDAQ Options Market) have a combined market share of 25.55%.[25] None of these four entities (which control over 93% of the market) could afford to charge opportunistic fees that resulted in being placed at the bottom of an order routing table and losing market share to competitors.

In the case of C2, it is particularly unlikely that an innovative pricing approach could cause competitive harm to the options market or to market participants. C2 is a new market participant that currently handles only about 1.45% percent of total market share in options trading.[26] Thus, the proposed rule is a modest attempt by a new market entrant to attract order volume away from more established competitors by adopting an innovative pricing strategy. C2 believes that this new pricing strategy will benefit the options markets and public consumers in particular. Indeed, it is well-established that new market entrants and new business models have procompetitive effects, and that innovations like the proposed rule can incentivize competitors to

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[24]   See Securities Exchange Act Release No. 61902 (April 14, 2010), 75 FR. 20738 (April 20, 2010) at 20759 (Proposed Amendments to Rule 610 of Regulation NMS) (File No. S7-09-10).

[25]   Market share for November 2012, as provided by the Options Clearing Corporation (available at http://www.optionsclearing.com/webapps/exchange-volume).

[26]   Id.

develop their own innovations in response. See, e.g., Leegin Creative Leather Prods. v. PSKS,

Inc., 551 U.S. 877, 891 (2007) ("New products and new brands are essential to a dynamic

economy"); Brooke Group v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 243 (1993)

(noting that "sound antitrust policy" encouraged "maverick" pricing strategies because of their

procompetitive effects); U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger

Guidelines ¶ 2.1.5 (expressing view of DOJ and FTC that "maverick" firms benefit consumers

by "threaten[ing] to disrupt market conditions with a new technology or business model,"

"tak[ing] the lead in price cutting or other competitive conduct," and "resist[ing] otherwise

prevailing industry norms"). The fact that an exchange proposes something new is a reason to be

receptive, not skeptical—innovation is the life-blood of a vibrant competitive market—and that

is particularly so in the case of a new market entrant of relatively small size like C2 that can

cause no widespread competitive harm if the proposed fees structure fails to attract significant

order volume.

Access to exchange quotes is also more efficient than ever and helps to promote price

transparency and competition among exchanges for order flow. Orders are processed and

executed electronically in milliseconds (also very different than 10 years ago) and markets are

more open to new users than ever before. Under the NMS plan for order protection in listed

options ("Options Linkage Plan"), each participating options exchange is required "to establish,

maintain, and enforce written policies and procedures as approved by the Commission that are

reasonably designed to prevent Trade-Throughs" in each exchange's listed options contracts.[27]

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[27]   See Securities Exchange Act Release No. 60405 (July 30, 2009), 74 FR 39362 (August 6,
       2009) at 39264-65 (Joint Industry Plan; Order Approving the National Market System
       Plan Relating to Options Order Protection and Locked/Crossed Markets Submitted by the
       Chicago Board Options Exchange, Incorporated, International Securities Exchange, LLC,
       The NASDAQ Stock Market LLC, NASDAQ OMX BX, Inc., NASDAQ OMS PHLX,

When more than one exchange is displaying the NBBO (which is overwhelmingly the case), brokers often assign lowest priority in their order routing tables to the exchange with the highest transaction fees. This means that if an exchange sets high fees, it risks losing business to exchanges with lower fees—the same competitive pressure used by our free markets every day to constrain price.

Indeed, order routers' ability to effectively view all exchanges' displayed prices simultaneously and execute at the exchange that charges the lowest fees is *more* disciplining than the market forces that operate in many other industries. A customer in the market for a new television, for instance, cannot simultaneously know the price of every television at every retail store. And even if all those prices were known, transaction costs often would prevent the customer from buying at the lowest price—perhaps the cheapest television is twenty miles away, for example. In the options markets, by contrast, order routers can simultaneously view and execute orders at the exchange with the lowest transaction fees when more than one exchange has, or may match, the NBBO. Plus, broker-dealers, who have accepted responsibility for handling orders on behalf of customers, are monitoring displayed quotes. They are typically more sophisticated and better-informed market participants than customers in non-financial markets, and therefore are better able to make the types of decisions that will produce efficient markets and constrain prices.

Options exchanges have adopted different pricing models ("Make or Take" or "Broker Payment") based on their competitive assessment of the incentives that will best attract order flow and liquidity. This competition has helped to exert competitive pressure on the exchanges' transaction fees. The Exchange believes that its proposed model will help further competition by

Inc., NYSE Amex LLC, and NYSE Arca, Inc.).

providing market participants with yet another option in determining where to execute orders and post liquidity. By expanding the universe of pricing models, the Exchange's proposal will help competition to achieve one of its signature benefits, i.e., allowing the marketplace to determine which pricing model best serves consumer needs.

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

C2 does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. On the contrary, C2 believes that the proposed rule change will promote competition. A new, original, different fee structure benefits investors and the market in general by providing a new and different option for investors to consider when they decide which exchange provides the most attractive option for directing order flow.

In the case of C2, it is particularly unlikely that an innovative pricing approach could cause competitive harm to the options market or to market participants. C2 is a new market participant that currently handles only about 1.45% percent of total market share in options trading.[28] Thus, the proposed rule is a modest attempt by a new market entrant to attract order volume away from more established competitors by adopting an innovative pricing strategy. C2 believes that this new pricing strategy will benefit the options markets and public consumers in particular. Indeed, it is well-established that new market entrants and new business models have procompetitive effects, and that innovations like the proposed rule can incentivize competitors to develop their own innovations in response. See, e.g., Leegin Creative Leather Prods. v. PSKS, Inc., 551 U.S. 877, 891 (2007) ("New products and new brands are essential to a dynamic economy"); Brooke Group v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 243 (1993)

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[28]   Market share for November 2012, as provided by the Options Clearing Corporation (available at http://www.optionsclearing.com/webapps/exchange-volume).

(noting that "sound antitrust policy" encouraged "maverick" pricing strategies because of their procompetitive effects); U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines ¶ 2.1.5 (expressing view of DOJ and FTC that "maverick" firms benefit consumers by "threaten[ing] to disrupt market conditions with a new technology or business model," "tak[ing] the lead in price cutting or other competitive conduct," and "resist[ing] otherwise prevailing industry norms"). The fact that an exchange proposes something new is a reason to be receptive, not skeptical—innovation is the life-blood of a vibrant competitive market—and that is particularly so in the case of a new market entrant of relatively small size like C2 that can cause no widespread competitive harm if the proposed fees structure fails to attract significant order volume.

Access to exchange quotes is also more efficient than ever and helps to promote price transparency and competition among exchanges for order flow. Orders are processed and executed electronically in milliseconds (also very different than 10 years ago) and markets are more open to new users than ever before. Under the Options Linkage Plan, each participating options exchange is required "to establish, maintain, and enforce written policies and procedures as approved by the Commission that are reasonably designed to prevent Trade-Throughs" in each exchange's listed options contracts.[29] When more than one exchange is displaying the NBBO (which is overwhelmingly the case), brokers often assign lowest priority in their order routing tables to the exchange with the highest transaction fees. This means that if an exchange

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[29]   See Securities Exchange Act Release No. 60405 (July 30, 2009), 74 FR 39362 (August 6, 2009) at 39264-65 (Joint Industry Plan; Order Approving the National Market System Plan Relating to Options Order Protection and Locked/Crossed Markets Submitted by the Chicago Board Options Exchange, Incorporated, International Securities Exchange, LLC, The NASDAQ Stock Market LLC, NASDAQ OMX BX, Inc., NASDAQ OMS PHLX, Inc., NYSE Amex LLC, and NYSE Arca, Inc.).

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Options exchanges have adopted different pricing models ("Make or Take" or "Broker Payment") based on their competitive assessment of the incentives that will best attract order flow and liquidity. This competition has helped to exert competitive pressure on the exchanges' transaction fees. The Exchange believes that its proposed model will help further competition by providing market participants with yet another option in determining where to execute orders and post liquidity. By expanding the universe of pricing models, the Exchange's proposal will help competition to achieve one of its signature benefits, i.e., allowing the marketplace to determine which pricing model best serves consumer needs.

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)[30] of the

Act and paragraph (f) of Rule 19b-4[31] thereunder. At any time within 60 days of the filing of the

proposed rule change, the Commission summarily may temporarily suspend such rule change if

it appears to the Commission that such action is necessary or appropriate in the public interest,

for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV.   Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning

the foregoing, including whether the proposed rule change is consistent with the Act. Comments

may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-C2-2013-
  004 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 Number SR-C2-2013-004. This file number should be

included on the subject line if e-mail is used. To help the Commission process and review your

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[30]   15 U.S.C. 78s(b)(3)(A).

[31]   17 C.F.R. 240.19b-4(f).

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 Number SR-C2-2013-004 and should be submitted by [insert date 21 days from the date

of publication in the Federal Register].

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

authority.[32]

Kevin M. O'Neill
Deputy Secretary

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[32]   17 CFR 200.30-3(a)(12).