SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–72986; File No. SR–CBOE–2014–017]

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving a Proposed Rule Change, as Modified by Amendment 1, To Amend Its Rules Related to Complex Orders

September 4, 2014.

I. Introduction

On February 19, 2014, Chicago Board Options Exchange, Incorporated (the ''Exchange'' or ''CBOE'') filed with the Securities and Exchange Commission (the ''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 its rules relating to complex orders. On March 3, 2014, the Exchange filed Amendment No. 1 to the proposed rule change. The proposed rule change, as modified by Amendment No. 1 thereto, was published for comment in the **Federal Register** on March 10, 2014.[3] On April 23, 2014, the Commission extended the time period in which to either approve the proposal, disapprove the proposal, or to institute proceedings to determine whether to approve or disapprove the proposal, to June 6, 2014.[4] On June 5, 2014, the Commission instituted proceedings to determine whether to approve or disapprove the proposed rule change.[5] The Commission then received two comment letters on proposal.[6] This order approves the proposed rule change.

II. Description of Proposed Rule Change

Under current CBOE Rule 6.53C(d)(ii), a Trading Permit Holder representing a COA-eligible order may request that the Exchange initiate a complex order auction (''COA'') for the COA-eligible order before such order enters the complex order book (''COB'').[7] In this proposed rule change, the Exchange proposes to require all complex orders with three or more legs to be subject to a COA prior to entering the COB.[8] Specifically, the Exchange proposes to amend Rule 6.53C(d)(ii) to provide that CBOE's Hybrid Trading System [9] (the ''System'') will initiate a COA on receipt of: (1) A COA-eligible order with two legs and request from the Trading Permit Holder representing the order that it initiate a COA; or (2) a complex order with three or more legs, regardless of the order's routing parameters (*e.g.,* a request to route directly to the COB) or handling instructions (except for orders routed for manual handling).[10] Thus, as proposed, all complex orders in Hybrid classes with three or more legs would automatically be subject to a COA (other than those routed for manual handling) prior to entering the COB where they can leg into the market.[11]

The Exchange proposes to amend CBOE Rule 6.53C(d)(ii) to provide that CBOE's System will reject back to a Trading Permit Holder any complex order with three or more legs that includes a request pursuant to CBOE Rule 6.53C, Interpretation and Policy .04 [12] that the order not initiate a COA.[13] The Exchange also proposes to amend CBOE Rule 6.53C(d)(ii), which currently provides that only a Trading Permit Holder representing an order may request that the order initiate a COA, to also provide that PAR operators handling an order may request that a COA-eligible order initiate a COA.[14]

According to the Exchange, this proposed rule change will address the concern that market makers may reduce the size of their quotations in the leg markets because of the presence of certain complex orders that are designed to circumvent the ''Quote Risk Monitor Mechanism'' (''QRM'') settings established by market makers.[15] CBOE describes the QRM as a functionality designed to help market makers provide liquidity across most series in their appointed classes without being at risk of executing the full cumulative size of all their quotes before being given adequate opportunity to adjust their quotes.[16]

The QRM, according to CBOE, generally operates by allowing market makers to set a variety of parameters, which, if triggered, will cause the System to cancel a market maker's quotes in all series in an appointed class after executing the order that triggered the parameter.[17] CBOE states that the System performs the QRM parameter calculations to determine if the QRM has been triggered after each execution against a market maker's quotes.[18] According to the Exchange, when a complex order legs into the regular market (*i.e.,* executes against individual quotes for each of the legs in the regular market), all of the legs of a complex order are considered as a single execution for purposes of the QRM, and

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

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 71648 (March 5, 2014), 79 FR 13359 (''Notice'').

[4] *See* Securities Exchange Act Release No. 72008, 79 FR 24032 (April 29, 2014).

[5] *See* Securities Exchange Act Release No. 72329, 79 FR 33627 (June 11, 2014).

[6] *See* letter to Kevin M. O'Neill, Deputy Secretary, Commission, from John Kinahan, Interim-CEO, Group One Trading, L.P., dated July, 7, 2014 (''Group One Letter''); and letter to the Office of the Secretary, Commission, from Martha Redding, Chief Counsel and Assistant Corporate Secretary, NYSE, Inc., dated July 10, 2014 (''NYSE Letter'').

[7] Under current CBOE Rule 6.53C(d)(i)(2), the Exchange may determine on a class-by-class basis which complex orders are eligible for a COA, including by complex order type and origin type. The Exchange notes that currently, in all Hybrid classes, customer, firm and broker-dealer complex orders are eligible for a COA, and all complex order types except for immediate-or-cancel (''IOC'') orders are eligible for a COA in all Hybrid classes. *See* Notice, *supra* note 3, n.8. Additionally, only marketable orders and ''tweeners'' (limit orders bettering the same side of the derived net market) are eligible for a COA. For Hybrid 3.0 classes (*i.e.* SPX), all complex order types (including IOC orders) are eligible for a COA, but only customer complex orders are eligible for a COA. *See id.* (citing CBOE Regulatory Circulars RG06–73, RG08–38, and RG08–97).

[8] The Exchange explains that this proposed change applies to Hybrid classes only, and not Hybrid 3.0 classes. *See* Notice, *supra* note 3, n.7. In this regard, the proposed rule change proposes to amend CBOE Rule 6.53C, Interpretation and Policy .10 to indicate that complex orders in Hybrid 3.0 classes, regardless of the number of legs, will initiate a COA in the same manner they currently do. *See id.*

[9] The proposed rule change proposes to amend CBOE Rule 6.53C(d)(ii) to say that the System, rather than the Exchange, will send the RFR message. *See id.* at n.9. Because the System will automatically send the RFR message when the conditions set forth in CBOE Rule 6.53C(d)(ii) are met, the Exchange believes using the term ''System'' in the rule text is appropriate. *See id.*

[10] The Exchange explains that if a complex order with three or more legs contains an instruction to route for manual handling, such as to PAR, and through such manual handling routes to the COB, the proposed rule change would provide that such order will initiate a COA prior to entry on the COB, even if the PAR operator requests that the order not initiate a COA. *See* Notice, *supra* note 3, n.10.

[11] The Exchange states that this automatic initiation of a COA does not apply to stock-option orders. *See id.* at n.11.

[12] CBOE Rule 6.53C, Interpretation and Policy .04 provides that Trading Permit Holders routing complex orders directly to the COB may request that the complex orders initiate a COA on a class-by-class basis and Trading Permit Holders with resting complex orders on PAR may request that complex orders initiate a COA on an order-by-order basis.

[13] *See* Notice, *supra* note 3, at 13362.

[14] CBOE believes that permitting orders resting on PAR to initiate a COA is consistent with other CBOE rules. *See id.* at n. 15 and accompanying text (citing to CBOE Rule 6.53C(d), which, according to the Exchange, states that complex orders may be subject to a COA once on PAR, and CBOE Rule 6.53C, Interpretation and Policy .04(a), which, according to the Exchange, states that Trading Permit Holders with resting complex orders on PAR may request that complex orders initiate a COA).

[15] *See* Notice, *supra* note 3, at 13363.

[16] *See id.* at 13361.

[17] *See id.* at 13360–61. CBOE states that the System performs the parameter calculations after an execution against a market maker quote occurs in order to assure that all quotations are firm for their full size. *See id.* at 13361.

[18] *See id.*

not as a series of individual transactions, because each leg of the complex order is contingent on the other leg.[19] Thus, the System performs the QRM parameter calculations after the entire complex order executes against interest in the regular market. In contrast, if the legs of the complex order had been submitted to the regular market separately and without any complex order contingency, the System would perform the QRM parameter calculations after each leg executed against interest in the regular market. According to the Exchange, this differential treatment may result in market makers exceeding their risk parameters by a greater number of contracts when complex orders leg into the regular market.[20]

The Exchange believes that the potential risk to market makers of complex orders legging into the regular market limits the amount of liquidity that market makers are willing to provide in the regular market.[21] In particular, according to the Exchange, market makers may reduce the size of their quotations in the regular market because of the presence of these complex orders that are designed to circumvent QRM and risk the execution of the cumulative size of market makers' quotations across multiple series without market makers' being aware of these complex orders or having an opportunity to adjust their quotes.[22] Accordingly, the Exchange believes that reducing market maker risk in the regular market by requiring complex orders in Hybrid classes with three or more legs to be subject to a COA—which will allow market makers to react accordingly, including adjusting their quotes to avoid the circumvention of their QRM parameter settings—will benefit investors by encouraging market makers to provide additional liquidity in the regular market and enhance competition in those classes.[23] According to the Exchange, this potential benefit to investors far exceeds any ''perceived detriment'' to requiring certain complex orders to be subject to a COA prior to potential interaction with the leg markets.[24] The Exchange notes that complex orders with three or more legs will still have opportunities for execution through a COA, in the COB or in the leg markets if they do not execute at the end of the COA.[25]

In the Notice, the Exchange states that it will announce the implementation date of the proposed rule change in a Regulatory Circular to be published no later than 90 days following the effective date of this proposed rule change.[26] The Exchange also states that the implementation date will be no later than 180 days following the effective date of this proposed rule change.[27]

III. Summary of Comment Letters

As noted above, the Commission received two comments, both expressing support for the proposed rule change.[28] One commenter stated that it believes CBOE's proposal is a reasonable response to the problem of complex orders circumventing market makers QRM parameters.[29] The other commenter stated that it believes that the proposal will allow market makers to better rely on the Exchange's QRM to remove quotes when a market makers risk tolerance is exceed, which, according to the commenter, will allow market makers to provide quotations with large sizes and tight spreads.[30]

IV. Discussion and Commission 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.[31] In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,[32] 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. The Commission notes that participating in a COA will provide complex orders with three or more legs an opportunity for price improvement through the auction mechanism. The Commission also notes that both commenters expressed support for the proposal.

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[33] that the proposed rule change (SR–CBOE–2014–017) is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[34]

Kevin M. O'Neill,

Deputy Secretary.

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[19] *See id.*

[20] *See id.*

[21] *See* Notice, *supra* note 3, at 13362.

[22] *See id.*

[23] *See id.*

[24] *See id.*

[25] *See id.*

[26] *See* Notice, *supra* note 3, at 13363.

[27] *See id.*

[28] *See supra* note 6.

[29] *See* NYSE Letter, *supra* note 6, at 2.

[30] *See* Group One Letter, *supra* note 6, at 2.

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

[32] 15 U.S.C. 78f(b)(5).

[33] 15 U.S.C. 78s(b)(2).

[34] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–72990; File No. SR–CBOE–2014–068]

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to the Strike Setting Regimes for SPY and DIA Options

September 4, 2014.

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 August 28, 2014, 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 and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend Interpretation .08 to Rule 5.5 (Series of Option Contracts Open for Trading) to modify the strike setting regimes for options on The Standard & Poor's Depository Receipts Trust (''SPY'') and The DIAMONDS Trust (''DIA''). The text of the proposed rule change is provided below. (additions are *italicized;* deletions are [bracketed])

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Chicago Board Options Exchange, Incorporated Rules

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

[2] 17 CFR 240.19b–4.