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 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.

[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).

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

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

Kevin M. O'Neill,

Deputy Secretary.

[FR Doc. 2012–8784 Filed 4–11–12; 8:45 am]

BILLING CODE 8011–01–P

[89] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–66759; File No. SR–CBOE–2012–005]

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

April 6, 2012.

I. Introduction

On February 7, 2012, the Chicago Board Options Exchange, Incorporated (''CBOE'' or ''Exchange''), 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 CBOE Rule 6.53C, ''Complex Orders on the Hybrid System,'' to, among other things, revise CBOE'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

CBOE proposes to amend CBOE Rule 6.53C to adopt new definitions of complex order and stock-option order, and to make several changes to its procedures for electronically executing stock-option orders.

A. Definitions of Complex Order and Stock-Option Order

CBOE Rule 6.53C(a) currently defines complex orders, including stock-option orders, in terms of enumerated strategies. The proposal replaces these enumerated strategies with general definitions of complex order[4] and stock-option order.[5] According to CBOE, the investing industry creates new and legitimate investment strategies that do not necessarily fit within the current narrow definitions of complex order types, and, as a result, bona fide transactions to limit risk are not afforded the facility of execution provided to more common complex orders.[6] CBOE believes that more general definitions will provide greater flexibility in the design and use of complex strategies.[7] CBOE notes that its new definitions of complex order and stock-option order are consistent with those of another options exchange[8] and with CBOE Rule 6.80(4).

CBOE Rule 6.53C(c)(iii) currently permits only complex orders with no more than four legs to be placed in the Complex Order Book (''COB''). CBOE 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 CBOE on a class-by-class basis, will be eligible for electronic processing.[9]

B. Execution of Stock-Option Orders

1. Legging of Stock-Option Orders

Currently, complex orders, including stock-option orders, may trade with other complex orders or by ''legging'' with the individual orders and quotes in CBOE's and CBSX's electronic books (''EBooks'') for the individual component legs, provided that the complex order can be executed in full, or in a permissible ratio, by the orders and quotes in the EBooks for the individual component legs.[10] In the case of a stock-option order that is legged, the stock component of the order would trade with CBSX's EBook and the option

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

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 66394 (February 14, 2012), 77 FR 10026 (''Notice'').

[4] CBOE proposes to define a complex order as any order for the same account involving the execution of two or more different options series in the same underlying security occurring at or near the same time in a ratio that is equal to or greater than one-to-three (.333) and less than 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. *See* CBOE Rule 6.53C(a)(1).

[5] CBOE proposes to define a stock-option order as any order for the same account 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). *See* CBOE Rule 6.53C(a)(2).

[6] *See* Notice, 77 FR at 10032.

[7] *See id.*

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

[9] *See* CBOE Rule 6.53C(a)(1) and (2).

[10] *See, e.g.,* CBOE Rule 6.53C, Interpretation and Policy .06(c) and (d).

series leg(s) would trade with CBOE's EBook.[11]

The proposal revises CBOE Rule 6.53C, Interpretation and Policy .06 to provide that stock-option orders will execute against other stock-option orders through COB and the Complex Order RFR Auction (''COA''), rather than by legging against individual orders and quotes.[12] CBOE believes that this change will 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.[13]

The proposal retains the legging functionality for an eligible market stock-option order that cannot be executed in full or in a permissible ratio at the conclusion of a COA.[14] At the conclusion of a COA, any remaining balance of the option leg(s) of an eligible market stock-option order will continue to route to the Hybrid System for processing as a simple market order(s), and CBOE will electronically transmit any remaining balance of the stock leg to a designated broker-dealer (as described below) for processing as a market order.[15] The designated broker-dealer will represent the stock leg on behalf of the party that submitted the stock-option order.

CBOE believes that the order eligibility parameters for eligible market stock-option orders 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).[16]

2. Eligible Market Orders

For purposes of the legging functionality, an eligible market order is a stock-option order that is within certain parameters determined by CBOE, and for which the NBBO is within designated size and price parameters, as determined by CBOE for the individual leg.[17] Currently, CBOE may determine the NBBO price parameters based on a minimum bid price for sell orders and a maximum sell price for buy orders.[18] The proposal eliminates the provision permitting CBOE to specify a designated NBBO price parameter based on a maximum offer price for buy orders because CBOE does not intend to utilize this parameter.[19]

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

Under the proposal, CBOE will electronically communicate the stock leg of a stock-option order to a designated broker-dealer(s) for execution on behalf of a Trading Permit Holder, rather than routing the stock leg to CBSX.[20] CBOE believes that this procedure will provide a more efficient means for processing stock-option orders.[21] To participate in stock-option order automated processing, a Trading Permit Holder must enter into a brokerage agreement with one or more designated broker-dealers that are not affiliated with CBOE.[22] However, CBOE notes that this process is not exclusive, and that Trading Permit Holders will be able to continue using open outcry procedures to execute stock-option orders if they choose to do so.[23]

CBOE 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 has determined that a stock-option order trade is possible and at what net prices.[24] 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.[25] After CBOE communicates the stock orders to the designated broker-dealer for execution, the broker-dealer will be responsible for determining whether the orders may be executed in accordance will all of the rules applicable to the execution of equity orders, including compliance with the applicable short sale, trade-through, and reporting rules.[26]

A Trading 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,[27] and a Trading Permit Holder submitting a stock-option order represents that the order complies with the QCT Exemption.[28] In addition, as described more fully in the Notice, CBOE's Hybrid System will validate compliance with the QCT Exemption with respect to each matched order communicated to the designated broker-dealer.[29]

CBOE intends to file a separate proposal to establish fees related to the routing of the stock portion of a stock-option order.[30]

C. Allocation Algorithms and Priority

1. COB and COA Allocation Algorithms

Currently, stock-option orders in COB may execute against other stock-option orders or against individual orders and quotes in the EBook.[31] Because CBOE will no longer permit the legging of stock-option orders in COB against individual orders and quotes in the component legs, the proposal amends the COB algorithm to provide that stock-option orders that are marketable against each other will execute automatically.[32] 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,[33] or

[11] *See* Notice, 77 FR at footnote 10.

[12] CBOE will retain legging functionality in one limited circumstance, as described below. *See* CBOE Rule 6.53C, Interpretation and Policy .06(d).

[13] *See* Notice, 77 FR at 10028.

[14] *See* CBOE Rule 6.53C, 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 CBOE on a class-by-class basis, and for which the NBBO is within designated size and price parameters, as determined by CBOE for the individual leg. *See* CBOE Rule 6.53C, Interpretation and Policy .06(d).

[15] *See* CBOE Rule 6.53C, Interpretation and Policy .06.

[16] *See* Notice, 77 FR at 10028.

[17] *See* CBOE Rule 6.53C, Interpretation and Policy .06(d).

[18] *See* CBOE Rule 6.53C, Interpretation and Policy .06(d).

[19] *See* Notice, 77 FR at footnote 16.

[20] *See* CBOE Rule 6.53C, Interpretation and Policy .06(a). As described above, CBOE may continue to route to CBSX the stock leg of an eligible market stock-option order that cannot be executed in full or in a permissible ratio at the conclusion of a COA. *See* CBOE Rule 6.53C, Interpretation and Policy .06(d).

[21] *See* Notice, 77 FR at 10027.

[22] *See* CBOE Rule 6.53C, Interpretation and Policy .06(a).

[23] CBOE notes that stock-option orders may be represented in open outcry by floor brokers or by CBOE PAR officials. *See* Notice, 77 FR at footnote 9. *See also* CBOE Rules 6.45A(b) and 6.45B(b).

[24] *See* Notice, 77 FR at 10026.

[25] *See* Notice, 77 FR at 10026–10027.

[26] *See* Notice, 77 FR at 10027.

[27] 17 CFR 242.611(a). *See* Securities Exchange Act Release No. 57620 (April 4, 2008), 73 FR 19271 (April 9, 2008) (order modifying the QCT Exemption). *See also* Securities Exchange Act Release No. 54389 (August 31, 2006), 71 FR 52829 (September 7, 2006) (order establishing the QCT Exemption).

[28] *See* CBOE Rule 6.53C, Interpretation and Policy .06(a).

[29] *See* Notice, 77 FR at 10027.

[30] *See* Notice, 77 FR at 10026–10027.

[31] *See* CBOE Rule 6.53C, Interpretation and Policy .06(b), (c), and (f).

[32] *See* CBOE Rule 6.53C, Interpretation and Policy .06(c).

[33] *See id.* CBOE notes that the allocation algorithms for the individual series legs include

pursuant to another allocation algorithm designated by CBOE under CBOE Rule 6.53C, Interpretation and Policy .09.[34]

Stock-option orders in COA, like stock-option orders in COB, currently may execute against other stock-option orders or against individual orders and quotes in the EBook.[35] Because CBOE will no longer permit the legging of stock-option orders in COA against individual orders and quotes in the component legs, except in the limited circumstance noted above, the proposal amends the COA algorithm to provide that stock-option orders executed against other stock-option orders through COA will trade first at the best net price(s) and, at the same price, in the sequence set forth in CBOE Rule 6.53C(d)(2)–(4).[36]

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 CBOE's EBook.[37] To satisfy this condition, the individual options legs of the stock-option order: (1) Must not trade at a price that is inferior to CBOE's best bid (offer) in the individual component series; and (2) must not trade at CBOE's best bid (offer) in the individual component series if one or more public customer orders are resting at the best bid (offer) in each of the component series and the stock-option order could otherwise be executed in full or in a permissible ratio.[38]

D. Provisions Applicable to Marketable Stock-Option Orders

Several provisions in the proposal address the handling of stock-option orders that become marketable. First, to the extent that a marketable stock-option order cannot be executed in full, or in a permissible ratio, after it is routed to COB or following a COA, any part of the order that can execute will execute and the remaining balance will be routed on a class-by-class basis to PAR or, at the order entry firm's discretion, to the order entry firm's booth.[39] If the order is not eligible to route to PAR, the remaining balance will be cancelled.[40]

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.[41] The derived net market will be calculated using CBOE's best bid or offer for the individual option series leg(s) and the NBBO for the stock leg.[42] CBOE 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.[43] CBOE notes that this system feature will not be applicable to a resting stock-option order that becomes marketable against another stock-option order(s).[44]

E. Price Check Parameters

CBOE proposes to adopt a new price check parameter applicable to the electronic processing of stock-option orders.[45] This price check parameter would allow CBOE to determine, on a class-by-class basis, and announce to Trading Permit Holders via Regulatory Circular, not to automatically execute a marketable stock-option order if, following a COA, the execution would not be within the acceptable derived net market for the strategy that existed at the start of the COA.[46] Such an order would route on a class-by-class basis to PAR or, at the order entry firm's discretion, to the order entry firm's booth.[47] If the order is not eligible to route to PAR, the remaining balance would be cancelled.[48]

The ''acceptable derived net market'' for a strategy will be calculated using CBOE'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.[49] CBOE will determine the ''acceptable tick distance'' on a class-by-class and premium basis.[50] CBOE believes that 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 CBOE's best bid and offer.[51] CBOE believes that 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 CBOE believes that 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.[52] CBOE 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[53] may be executed outside the NBBO for the stock.[54] Accordingly, in establishing the acceptable tick distance for the stock leg of the order, CBOE would have the flexibility to use the NBBO (which would equate to an acceptable tick

price-time, pro-rata, and the ultimate matching algorithm (''UMA'') base priorities, and a combination of various optional priority overlays pertaining to public customer priority, Market Maker participation entitlement, small order preference, and market turner. *See* Notice, 77 FR at footnote 17. *See also* CBOE Rules 6.45A and 6.45B.

[34] CBOE Rule 6.53C, Interpretation and Policy .09 allows CBOE to determine, on a class-by-class basis, which electronic matching algorithm from CBOE Rule 6.45A or 6.45B, as applicable, will apply to executions in COB in lieu of the algorithm specified in CBOE Rule 6.53C(c)(ii)(2) and (3).

[35] *See* CBOE Rule 6.53C, Interpretation and Policy .06(b), (d), and (f).

[36] *See* CBOE Rule 6.53C, Interpretation and Policy .06(d). Under Interpretation and Policy .06(d), as amended, a stock-option order that was subject to a COA would execute against other stock-option orders first, at the best net price(s) and, at the same price, in the following sequence: (i) Against public customer stock-option orders resting in COB before, or received during, the COA Response Time Interval, and public customer RFR Responses, with multiple public customer orders ranked by time priority; (ii) against non-public customer orders resting in COB before the COA Response Time Interval, with multiple orders subject to the UMA allocation in CBOE Rule 6.45A or 6.45B, as applicable; and (iii) against non-public customer orders resting in COB that are received during the COA Response Time Interval, and non-public customer RFR Responses, with multiple orders subject to the CUMA allocation in CBOE Rule 6.45A or 6.45B, as applicable.

[37] *See* Notice, 77 FR at 10028.

[38] *See* CBOE Rule 6.53C, Interpretation and Policy .06(a) and (d). *See also* Notice, 77 FR at 10028 and 10029.

[39] *See* CBOE Rule 6.53C, Interpretation and Policy .06(b)(1). The Commission notes that CBOE intends to file a separate proposed rule change to revise CBOE Rule 6.53C, Interpretation and Policy .06 and .08 to further describe booth routing parameters and related order management terminal operations. *See* email message from Jennifer Lamie, Assistant General Counsel, Legal Division, CBOE, to Yvonne Fraticelli, Special Counsel, and Brian Baltz, Attorney, Division of Trading and Markets, Commission, dated March 27, 2012.

[40] *See id.*

[41] *See* CBOE Rule 6.53C, Interpretation and Policy .06(a)(2). The order would not execute automatically against the derived net market because stock-option orders will no longer execute against the individual legs of the order, except in the limited circumstance described above.

[42] *See id.*

[43] *See* Notice, 77 FR at 10029.

[44] *See id.*

[45] *See* CBOE Rule 6.53C, Interpretation and Policy .08(f).

[46] *See* CBOE Rule 6.53, Interpretation and Policy .08(f)(1).

[47] *See* CBOE Rule 6.53C, Interpretation and Policy .08(f)(2). *See also* note 39, *supra.*

[48] *See id.*

[49] *See* CBOE Rule 6.53C, Interpretation and Policy .08(f)(1).

[50] *See id.*

[51] *See* Notice, 77 FR at footnote 21.

[52] *See id.*

[53] *See* note 27, *supra.*

[54] *See* Notice, 77 FR at footnote 21.

distance of 0) or a range outside the NBBO.[55]

In classes where this price check parameter is available, it will also be available for COA responses under CBOE Rule 6.53C(d), AIM and Solicitation Auction Mechanism stock-option orders and responses under CBOE Rules 6.74A and 6.74B, and customer-to-customer immediate cross stock-option orders under CBOE Rule 6.74A, Interpretation and Policy .08 (''CTC'').[56] Under these provisions, paired stock-option orders and responses will not be accepted except that, to the extent that only a paired contra-side order subject to an auction under CBOE Rule 6.74A or 6.74B 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, the Agency Order would continue processing as an unpaired stock option order (*e.g.,* the Agency Order would route to COB or COA for processing).[57] 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.[58]

CBOE also proposes to apply the existing individual series leg width price check parameter in CBOE Rule 6.53C, Interpretation and Policy .08(a)(i) to market and marketable limit stock-option orders.[59] Under this price check parameter, a market or marketable limit stock-option order in a class where the price check parameter was available would not be executed automatically if the width between CBOE's best bid and best offer in any individual series leg was not within an acceptable price range.[60]

CBOE believes that the price protection parameters will help to mitigate the potential risks associated with stock-option orders drilling through multiple price points, thereby resulting in executions that are extreme and potentially erroneous.[61]

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

CBOE Rule 6.53C, Interpretation and Policy .04(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 COA if the order is within a number of ticks away from current derived net market. The proposal extends 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 CBOE's best bid or offer in the individual option series leg(s) and the NBBO in the stock leg.[62] CBOE 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).[63] CBOE believes that this 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 Trading Permit Holder might do if the Trading Permit Holder were representing the stock-option order in open outcry or entering the order into COB.[64]

G. Rule Text Reorganizations

As described more fully in the Notice, CBOE also proposes various changes to reorganize and simplify the rules governing stock-option orders by, among other things, consolidating certain provisions in CBOE Rule 6.53C, Interpretation and Policy .06.[65]

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.[66] In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,[67] 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 believes that the new definitions could permit the electronic trading on CBOE of complex orders representing investment strategies that do not fall within the enumerated strategies in CBOE's current rule, including transactions designed to limit risk. 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[68] and in CBOE Rule 6.80(4).[69] In addition, the Commission believes that the rule changes 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 CBOE of additional complex orders.

B. Execution of Stock-Option Orders

1. Legging of Stock-Option Orders

The Commission believes that the proposal to revise CBOE Rule 6.53C, Interpretation and Policy .06 to provide for the execution of stock-option against other stock-option orders through COB and COA, rather than by legging against individual orders and quotes in the CBOE and CBSX EBooks, is consistent with the Act because it could facilitate the execution of stock-option 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.[70]

The Commission also believes that it is consistent with the Act for CBOE to retain the legging feature for eligible market stock-option orders that cannot be executed, in full or in a permissible ratio, at the conclusion of a COA because the legging functionality could provide an additional opportunity for these orders to be executed. The Commission notes that CBOE believes

[55] *See id.*

[56] *See* CBOE Rule 6.53C, Interpretation and Policy .08(f)(2). AIM, SAM and CTC are mechanisms that may be used to cross two paired orders. *See* Notice, 77 FR at footnote 22.

[57] *See* CBOE Rule 6.53C, Interpretation and Policy .08(f)(2) and Notice, 77 FR at 10030.

[58] *See* CBOE Rule 6.53C, Interpretation and Policy .08(f)(2).

[59] *See* CBOE Rule 6.53C, Interpretation and Policy .08(a) and Notice, 77 FR at 10030–10031.

[60] *See id.*

[61] *See* Notice, 77 FR at 10031.

[62] *See* CBOE Rule 6.53C, Interpretation and Policy .04(b).

[63] *See* Notice, 77 FR at 10031.

[64] *See id.*

[65] *See* Notice, 77 FR at 10031–10032.

[66] 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).

[67] 15 U.S.C. 78f(b)(5).

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

[69] 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.

[70] *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).

that the eligibility parameters for eligible market stock-option orders could help to mitigate the risks that may be associated with legging stock-option orders.[71]

2. Eligible Market Orders

The Commission believes that it is consistent with the Act for CBOE to modify the eligible market order parameter in CBOE Rule 6.53C, Interpretation and Policy .06(d) by eliminating the provision that allows CBOE to establish an NBBO price parameter for such orders based on a maximum offer price for buy orders. CBOE states that it does not intend to use this parameter.[72] Accordingly, the Commission believes that eliminating this parameter will help to assure that the rule accurately reflects the parameters that CBOE may use to identify eligible market stock-option orders.

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

As described more fully above, CBOE proposes to revise its rules to allow the Exchange to electronically communicate the stock leg of a stock-option order to a designated broker-dealer for execution on behalf of a Trading Permit Holder.[73] To participate in stock-option order automated processing, a Trading Permit Holder must enter into a brokerage agreement with one or more designated broker-dealers that are not affiliated with CBOE.[74]

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.[75] In addition, after CBOE communicates the paired stock orders to the designated broker-dealer for execution, the 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 the applicable short sale, trade-through, and reporting rules.[76] In addition, a Trading 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 Trading Permit Holder submitting a stock-option order represents that the order complies with the QCT Exemption.[77] As described more fully in the Notice, CBOE's Hybrid System will validate compliance with the QCT Exemption with respect to each matched order communicated to the designated broker-dealer.[78]

CBOE states that this automated process for executing stock-option orders is not exclusive, and that Trading Permit Holders will continue to be able to use open outcry procedures to execute stock-option orders if they choose to do so.[79]

The Commission notes that CBOE'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.[80] In addition, the Commission notes that Trading Permit Holders will continue to have the ability to use open outcry procedures to execute stock-option orders if they choose to do so. Accordingly, the Commission finds that the proposal to allow CBOE to electronically communicate the stock leg of a stock-option order to a designated broker-dealer that is not affiliated with CBOE for execution on behalf of a Trading Permit Holder is consistent with the Act.

C. Allocation Algorithms and Priority

1. COB and COA Allocation Algorithms

Because stock-option orders generally will not execute against individual leg market interest in the CBOE and CBSX EBooks, CBOE is eliminating references in CBOE Rule 6.53C, Interpretation and Policy .06 to executions of stock-option orders against individual orders and quotes. Instead, 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.[81] The Commission notes that this allocation provision for stock-option orders in COB is consistent with the existing complex order allocation provision in CBOE Rule 6.53C(c)(ii)(2).[82] Accordingly, the Commission believes that the allocation provision for marketable stock-option orders in COB is consistent with the Act.

Because CBOE will no longer permit the legging of stock-option orders in COA against individual orders and quotes in the component legs (except with respect to an eligible market stock-option order that cannot be executed following a COA), CBOE is amending the COA algorithm to eliminate the reference to executions against individual orders and quotes in the EBook, but retaining the remainder of the current stock-option order allocation algorithm in CBOE Rule 6.53C, Commentary .06(d). Accordingly, stock-option orders executed through COA will trade first at the best net price(s) and, at the same price, in the sequence set forth in CBOE Rule 6.53C(d)(v)(2)–(4).[83] The Commission believes that it is consistent with the Act for CBOE to continue to apply this allocation algorithm to stock-option 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 CBOE's EBook.[84] To satisfy this condition, the individual options legs of the stock-option order: (1) Must not trade at a price that is inferior to CBOE's best bid (offer) in the individual component series; and (2) must not trade at CBOE's best bid (offer) in the individual component series if one or more public customer orders are resting at the best bid (offer) in each of the component series and the stock-option order could otherwise be executed in full or in a permissible ratio. These provisions are consistent with CBOE's existing priority rules,[85] and with the rules of other

[71] *See* Notice, 77 FR at 10028. Under CBOE Rule 6.53C, Interpretation and Policy .06(d), as amended, an ''eligible market order'' is a stock-option order that is within the designated size and order type parameters determined by CBOE on a class-by-class basis, and for which the NBBO is within designated size and price parameters, as determined by CBOE for the individual leg. The designated NBBO price parameters will be determined based on a minimum bid price for sell orders. CBOE may determine on a class-by-class basis to limit the trading times within regular trading hours that the legging functionality will be available.

[72] *See* Notice, 77 FR at footnote 16.

[73] *See* CBOE Rule 6.53C, Interpretation and Policy .06(a).

[74] *See* CBOE Rule 6.53C, Interpretation and Policy .06(a).

[75] *See* Notice, 77 FR at 10026–10027.

[76] *See* Notice, 77 FR at 10027.

[77] *See* CBOE Rule 6.53C, Interpretation and Policy .06(a).

[78] *See* Notice, 77 FR at 10027.

[79] Stock-option orders may be represented in open outcry by floor brokers or by CBOE PAR officials. *See* Notice, 77 FR at footnote 9 and accompanying text. *See also* CBOE Rules 6.45A(b) and 6.45B(b).

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

[81] *See* CBOE Rule 6.53C, Interpretation and Policy .06(c). CBOE also could allocate stock-option orders pursuant to another allocation algorithm designated by CBOE under CBOE Rule 6.53C, Interpretation and Policy .09.

[82] CBOE Rule 6.53C(c) states that the allocation of complex orders in COB that are marketable against each other will be pursuant to the rules to trading priority otherwise applicable to incoming electronic orders in the individual component legs.

[83] *See* CBOE Rule 6.53C, Interpretation and Policy .06(d).

[84] *See* Notice, 77 FR at 10028.

[85] *See, e.g.,* CBOE Rules 6.45(e); 6.45A(b)(ii); and 6.45B(b)(ii).

options exchanges.[86] Accordingly, the Commission finds that the priority requirements for stock-option orders in CBOE Rule 6.53C, Commentary .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 in, or in a permissible ratio, after it is routed to COB or following a COA, any part of the order that can execute will execute and the remaining balance will be routed on a class-by-class basis to PAR or, at the order entry firm's discretion, to the order entry firm's booth.[87] If the order is not eligible to route to PAR, the remaining balance will be cancelled.[88] The Commission believes that these provisions are consistent with the Act because they establish procedures for handling 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.[89] The Commission believes that this provision is consistent with the Act because it could facilitate the execution of a stock-option order that is marketable against the derived net market, but that would not execute against the derived net market because stock-option orders generally will not execute against leg market interest.

E. Price Check Parameters

The stock-option derived net market price check parameter in CBOE Rule 6.53C, Interpretation and Policy .08(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 CBOE'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 CBOE with flexibility in setting this parameter. The Commission notes that a stock-option order submitted to the Hybrid System must comply with the QCT Exemption.[90] The stock leg of a stock-option order that complies with the QCT Exemption would be permitted to trade at a price that is outside the NBBO for the stock.

CBOE also proposes to extend the existing individual series leg width price check parameter in CBOE Rule 6.53C, Interpretation and Policy .08(a)(i), which currently applies to complex orders, to the individual series legs of market and marketable limit stock-option orders.[91] This price check parameter prevents the automatic execution of a marketable complex order when the width between CBOE's best bid and offer in any individual series leg is not within an acceptable price range. The Commission believes that it is consistent with the Act for CBOE to have the ability to apply this price check parameter to stock-option orders, in addition to complex orders.

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

CBOE proposes to amend CBOE Rule 6.53C, Interpretation and Policy .04(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 COA if the order is within a number of ticks away from current derived net market.[92] The Commission believes that applying the ''re-COA'' feature to stock-option orders could facilitate the execution of stock-option orders by providing an opportunity for a stock-option resting at the top of the COB to be executed automatically. Accordingly, the Commission finds that the provision is consistent with the Act.

G. Rule Text Reorganizations

The Commission believes that the proposed changes to reorganize, consolidate, and simplify CBOE Rule 6.53C, Interpretation and Policy .06 are consistent with the Act.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[93] that the proposed rule change (SR–CBOE–2012–005) is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[94]

Kevin M. O'Neill,

Deputy Secretary.

[FR Doc. 2012–8783 Filed 4–11–12; 8:45 am]

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

[87] *See* CBOE Rule 6.53C, Interpretation and Policy .06(a)(1). As noted above, CBOE plans to file a separate proposal that will further describe booth routing parameters and order management terminal operations. *See* note 39, *supra.*

[88] *See id.*

[89] *See* CBOE Rule 6.53C, Interpretation and Policy .06(a)(2). This system feature will not be applicable to a resting stock-option order that becomes marketable against another stock-option order(s).

[90] *See* CBOE Rule 6.53C, Interpretation and Policy .06(a).

[91] *See* CBOE Rule 6.53C, Interpretation and Policy .08(a)(5) and Notice, 77 FR at 10030—10031.

[92] *See* CBOE Rule 6.53C, Interpretation and Policy .04(b). CBOE will calculate the derived net market for a stock-option order using CBOE's best bid or offer in the individual option series leg(s) and the NBBO in the stock leg.

[93] 15 U.S.C. 78s(b)(2).

[94] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–66758; File No. SR–NYSE–2012–05]

Self-Regulatory Organizations; New York Stock Exchange LLC; Order Granting Approval of a Proposed Rule Change Amending NYSE Rule 476A To Update its ''List of Exchange Rule Violations and Fines Applicable Thereto Pursuant to Rule 476A''

April 6, 2012.

I. Introduction

On February 7, 2012, New York Stock Exchange LLC (''Exchange'' or ''NYSE'') 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 NYSE Rule 476A to update its ''List of Exchange Rule Violations and Fines Applicable Thereto Pursuant to Rule 476A.'' The proposed rule change was published for comment in the **Federal Register** on February 24, 2012.[3] The Commission received no comment letters on the proposed rule change. This order approves the proposed rule change.

II. Description

By way of background, NYSE Rule 476 governs disciplinary proceedings involving charges against members, member organizations, principal

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

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 66421 (February 17, 2012), 77 FR 11181 (''Notice'').