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

These proposed rule changes do not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange does not believe that any of these changes represent a significant departure from previous pricing offered by the Exchange or pricing offered by the Exchange's competitors. Additionally, Members may opt to disfavor EDGA's pricing if they believe that alternatives offer them better value. Accordingly, the Exchange does not believe that the proposed changes will impair the ability of Members or competing venues to maintain their competitive standing in the financial markets.

Flag A

The Exchange believes that its proposal to pass through a rebate of $0.0015 per share for Members' orders that yield Flag A would increase intermarket competition because it offers customers an alternative means to route to Nasdaq for the same price as entering orders in Tape C securities on Nasdaq directly. The Exchange believes that its proposal would not burden intramarket competition because the proposed rate would apply uniformly to all Members.

Flag C

The Exchange believes that its proposal to pass through a rebate of $0.0011 per share for Members' orders that yield Flag C would increase intermarket competition because it offers customers an alternative means to route to BX for the same price as entering orders on BX directly, provided those orders would have qualified for a volume based increased rebate. The Exchange believes that its proposal would not burden intramarket competition because the proposed rate would apply uniformly to all Members.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

The Exchange has not solicited, and does not intend to solicit, comments on this proposed rule change. The Exchange has not received any unsolicited written comments from Members or other interested parties.

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) of the Act [12] and Rule 19b–4(f)(2) [13] thereunder. At any time within 60 days of the filing of such 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 email to *rule-comments@sec.gov.* Please include File Number SR–EDGA–2013–27 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–EDGA–2013–27. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*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 Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–EDGA–2013–27 and should be submitted on or before October 9, 2013.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[14]

Kevin M. O'Neill,

Deputy Secretary.

[FR Doc. 2013–22650 Filed 9–17–13; 8:45 am]

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[12] 15 U.S.C. 78s(b)(3)(A).

[13] 17 CFR 240.19b–4 (f)(2).

[14] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–70381; File No. SR–CHX–2013–16]

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change To Adopt Standards for the Cancellation or Adjustment of Bona Fide Error Trades, the Submission of Error Correction Transactions, and the Cancellation or Adjustment of Stock Leg Trades of Stock-Option or Stock-Future Orders

September 12, 2013.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act") [1], and Rule 19b–4 [2] thereunder, notice is hereby given that on September 4, 2013 the Chicago Stock Exchange, Inc. ("CHX" or the "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. CHX has filed this proposal pursuant to Section 19(b)(2) of the Act.[3] 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 the Substance of the Proposed Rule Change

CHX proposes to amend Article 20, Rule 9 to outline and clarify the Exchange's current requirements for the cancellation of trades based on Bona Fide Error and to establish new requirements for the adjustment of trades based on Bona Fide Error; to adopt Article 20, Rule 9A to detail the Exchange's current requirements for Error Correction Transactions; and to

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

[2] 17 CFR 240.19b–4.

[3] 15 U.S.C. 78s(b)(2).

adopt Article 20, Rule 11 to amend the Exchange's current requirements for the cancellation of the stock leg trade of a Stock-Option order, to establish new requirements for the adjustment of the stock leg trade of a Stock-Option order, and to allow the stock leg trade of Stock-Future orders to be cancelled or adjusted pursuant to proposed Rule 11.

The text of this proposed rule change is available on the Exchange's Web site at (*www.chx.com*) and in 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 CHX included statements concerning the purpose of and basis for the proposed rule changes 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 CHX has prepared summaries, set forth in sections A, B and C below, of the most significant aspects of such statements.

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

1. Purpose

The Exchange proposes to amend Article 20, Rule 9 to outline and clarify the Exchange's current requirements for the cancellation of trades based on Bona Fide Error and to establish new requirements for the adjustment of trades based on Bona Fide Error; to adopt Article 20, Rule 9A to detail the Exchange's current requirements for Error Correction Transactions; and to adopt Article 20, Rule 11 to amend the Exchange's current requirements for the cancellation of the stock leg trade of a Stock-Option order, to establish new requirements for the adjustment of the stock leg trade of a Stock-Option order, and to allow the stock leg trade of Stock-Future orders to be cancelled or adjusted pursuant to proposed Rule 11.

Proposed Article 20, Rule 9 "Cancellation or Adjustment of Bona Fide Error Trades"

Current Article 20, Rule 9 outlines two bases for the cancellation of trades at the request of all parties to the trade. Specifically, current Article 20, Rule 9(a) provides that transactions made in "demonstrable error" [4] and cancelled by both parties may be unwound, subject to the approval of the Exchange. Although the Exchange has provided specific guidance to its Participants in the form of CHX Information Memorandums with respect to demonstrable error, the CHX rules are silent as to the specific requirements or processes involved in the demonstrable error trade cancellation process.[5] In sum, the Exchange currently requires "concrete, documented evidence that the initial trade was transacted in error or includes an erroneous term that requires the cancellation of the initial report." [6]

Moreover, current Article 20, Rule 9(b) outlines rules for the cancellation of the stock leg trade of a Stock-Option order. Specifically, current Article 20, Rule 9(b) provides that a trade representing the stock leg of a stock-option order may be cancelled at the request of all parties to the trade if, *inter alia,* market conditions in any of the non-Exchange markets prevent the options leg from executing at the price agreed upon by the parties or the options leg was cancelled by the exchange on which it was executed.

Although, both current Article 20, Rule 9(a) and Rule 9(b) require all the parties to the trade to consent to the cancellation of the trade, the reasons for each cancellation are substantively different. Given this difference, the Exchange proposes to separate current Article 20, Rule 9 into two different rules. The Exchange proposes to detail, *inter alia,* the requirements for the cancellation of trades based on demonstrable error under proposed Rule 9 and to detail, *inter alia,* the requirements for the cancellation of the stock leg of a stock-option order under proposed Rule 11.[7]

In sum, proposed Rule 9 ("Cancellation or Adjustment of Bona Fide Error Trades") retains the substance of current Article 20, Rule 9(a), with some amendments. Under proposed Rule 9, the Exchange proposes (1) to explicitly outline and expand the current requirements for *cancellations* of trades based on Bona Fide Error [8] and (2) to allow for *adjustments* of trades based on Bona Fide Error, provided that certain additional requirements are met.[9]

Specifically, proposed Rule 9(a) states that a trade executed on the Exchange in "Bona Fide Error," as defined under proposed Article 1, Rule 1(hh), may be cancelled or adjusted pursuant to this Rule, subject to the approval of the Exchange. The Exchange notes that proposed Rule 9 only applies to Bona Fide Error trades that were executed on the Exchange and, as such, orders that are routed to other market centers and executed at such away market centers are not within the purview of proposed Rule 9.[10] Moreover, the Exchange proposes to define "Bona Fide Error" exactly as defined in the Commission's release granting exemptive relief for Error Correction Transactions.[11] Thus, proposed Article 1, Rule 1(hh) defines "Bona Fide Error" as:

(1) the inaccurate conveyance or execution of any term of an order, including, but not limited to, price, number of shares or other unit of trading; identification of the security; identification of the account for which securities are purchased or sold; lost or otherwise misplaced order tickets; or the execution of an order on the wrong side of a market;

(2) the unauthorized or unintended purchase, sale, or allocation of

[4] Although not currently in the CHX rules, the Exchange defines "demonstrable error" as a "Bona Fide Error" exactly as defined under the "Order Exempting Certain Error Correction Transactions From Rule 611 of Regulation NMS Under the Securities Exchange Act of 1934." See Securities Exchange Act Release No. 55884 (June 8, 2007), 72 FR 32926 (June 14, 2007). As discussed below, the Exchange proposes to adopt this definition as proposed Article 1, Rule 1(hh).

[5] Among other things, these CHX Information Memorandums have provided evidentiary standards and parameters for trade cancellations based on demonstrable errors.

For instance, CHX Information Memorandum (MR–11–8) states the following, in pertinent part (*italics* added):

Cancellation of Transactions (CHX Article 20, Rule 9)

"Additionally, the Department wishes to highlight the CHX rule requirement that trades can only be cancelled or busted based on mutual agreement of all parties involved if the initial trade was done in *demonstrable error.* The same factors used in making a [Bona Fide Error] determination apply with equal force to proposed cancellations under Article 20, Rule 9. Proper documentary proof will be required at the time of such requests in this case as well. *While we cannot say in advance what may be considered adequate proof of demonstrable error, the basic standard will be concrete, documented evidence that the initial trade was transacted in error or includes an erroneous term that requires the cancellation of the initial report.* Examples might include transcribed evidence of the correct trade terms versus what was entered in error (*i.e.,* a price of $15.42 vs $51.42) or recorded evidence of a misconveyance of terms (*i.e.,* print stock ABC vs BAC). Requests will be reviewed on a case-by-case basis prior to being transacted by CHX Operations staff.

Finally, we note that trades may only be cancelled pursuant to CHX Article 20, Rule 9. The Exchange does not have the authority to modify or adjust the individual terms of previously reported transactions."

[6] *Id.*

[7] As discussed in great detail below, the Exchange proposes to clarify and expand the scope of current Article 20, Rules 9(a) and 9(b).

[8] *See supra* note 4.

[9] The Exchange notes that proposed Article 20, Rule 9 does not extinguish Participants' market access obligations pursuant to Rule 15c3–5 under the Act. *See* 17 CFR 240.15c3–5.

[10] Although the Exchange anticipates implementing it in the near future, the Exchange does not currently offer order routing.

[11] *See supra* note 4.

securities, or the failure to follow specific client instructions;

(3) the incorrect entry of data into relevant systems, including reliance on incorrect cash positions, withdrawals, or securities positions reflected in an account; or

(4) a delay, outage, or failure of a communication system used to transmit market data prices or to facilitate the delivery or execution of an order.

The Exchange notes that it currently permits trade cancellations based on Bona Fide Errors of the Participant submitting the order to the Matching System (''executing broker Participant'') or of the customer of the executing broker Participant, so long as the Bona Fide Error can be reasonably identified and supported by the executing broker Participant and verified by the Exchange. Thus, the Exchange proposes to clarify this limitation as proposed paragraph .01 of the Interpretations and Policies of proposed Rule 9. Specifically, proposed paragraph .01 provides that proposed Rule 9 shall only apply to Bona Fide Errors committed by the Participant that submitted the order to the Matching System or the customer of the Participant that submitted the order to the Matching System.

Proposed Rule 9(b) outlines the specific requirements that must be met by the executing broker Participant before the Exchange can consider a request to cancel or adjust an erroneous trade.[12] Specifically, proposed paragraph (b) states that the Exchange may approve a request for a trade cancellation or adjustment pursuant to this Rule and take the corrective action(s) necessary to effectuate such a cancellation or adjustment, provided that the items listed thereunder are submitted to the Exchange, in a form prescribed by the Exchange,[13] by the Participant that submitted the erroneous trade. Moreover, the proposed paragraph continues by stating that all of the requirements of the proposed paragraph must be complied with, to the satisfaction of the Exchange, before a trade cancellation or adjustment pursuant to this proposed Rule may be approved or any corrective action may be taken. In addition, the Exchange shall have sole discretion in determining whether the requirements of this Rule have been satisfied. Thereunder, the specific requirements are listed as proposed paragraphs (b)(1)–(3), which states as follows:

(1) *Timely written request.* The Participant that submitted the erroneous trade shall submit a written request for cancellation or adjustment, including all information and supporting documentation required by this Rule, including a Trade Error Report, no later than 4:30 p.m. CST on T+1. The Exchange will retain a copy of the written request, information and supporting documentation. In extraordinary circumstances, a cancellation or adjustment may be requested and effected after T+1, with the approval of an officer of the Exchange;

(2) *Bona Fide Error.* The Participant that submitted the erroneous trade shall identify the error that is a ''Bona Fide Error,'' as defined under Article 1, Rule 1(hh), and the source of the Bona Fide Error. The Participant shall also provide supporting documentation showing the objective facts and circumstances concerning the Bona Fide Error, such as the original terms of the order or a record of the misconveyance of terms; and

(3) *All parties consent.* The Exchange shall verify that the cancellation or adjustment is requested by all parties involved in the Bona Fide Error trade (or by an authorized agent of those parties). The Participant that submitted the erroneous trade shall provide supporting documentation evidencing this consent.

With respect to proposed paragraph (b)(1), although not currently stated in the CHX rules, the T+1 time requirement is the current time limit required by the Exchange for cancellation of trades based on demonstrable error. Based on its experience, the Exchange submits that the T+1 time requirement (*i.e.,* day of erroneous trade + one full trading day) is reasonable. The flexibility of the T+1 requirement is particularly necessary where the Bona Fide Error was not committed by the executing broker Participant, but by the customer of the executing broker Participant that relayed inaccurate order terms to the executing broker Participant. In such a case, the executing broker Participant would not have known, at the time the erroneous trade was executed, that the terms of the trade were erroneous. Thus, there would inevitably be some delay before the Bona Fide Error was discovered and the source of the error identified. Moreover, certain Bona Fide Errors may not be discovered until clearing submissions have been made. In such an instance, the T+1 requirement would be essential for Bona Fide Errors to surface. Furthermore, in recognizing that extraordinary circumstances may prevent compliance with the T+1 requirement, the Exchange submits that requiring approval of an officer of the Exchange to waive the T+1 requirement will allow the Exchange to verify that such extraordinary circumstances exist on a case-by-case basis and will consequently safeguard against the abuse of this exception.[14]

With respect to proposed paragraph (b)(2), the Exchange notes that the supporting documentation showing the objective facts and circumstances concerning the Bona Fide Error may differ, depending on the source and nature of the Bona Fide Error. Although it is difficult, if not impossible, to establish a general rule as to what would constitute sufficient documentation,[15] copies of verifiable communications (*e.g.,* email, instant message, recorded phone lines, internal order ticket) will usually be required by the Exchange when considering a request to cancel or adjust a trade made in Bona Fide Error.

With respect to proposed paragraph (b)(3), the Exchange notes that this requirement is designed to balance the need to adequately ascertain the intent of all parties to an erroneous trade and to address the practical difficulty of an executing broker Participant attempting to directly verify the consent of such parties where the executing broker Participant received an order from an authorized agent of the parties to the trade and not from the parties directly. Under these circumstances, the Exchange submits that it is reasonable that the consent to cancel or adjust an erroneous trade may be given by the authorized agent(s) of those parties. With that said, the Exchange notes that under no circumstances shall the Exchange consider a request to cancel or adjust a Bona Fide Error trade without documentation verifying the intent of the parties to the erroneous trade to cancel or adjust the trade.

If the executing broker Participant satisfies all of the requirements of proposed paragraph (b) to the satisfaction of the Exchange, a request to cancel a trade made in Bona Fide Error would be approved. However, if the executing broker Participant were to request a trade adjustment, the Exchange would take additional steps to

[12] Although the Exchange currently requires, inter alia, documentary proof of a Bona Fide Error prior to the Exchange considering a trade cancellation, there are no such requirements stated in the current CHX rules. *See supra* note 5.

[13] Prior to proposed Rule 9, Rule 9A, and Rule 11 becoming operative, the Exchange will provide all Participants with specific instructions, through a CHX Information Memo or the like, which will detail the ''form prescribed by the Exchange'' contemplated by proposed paragraph (b).

[14] The Exchange anticipates that the list of eligible officers would include the Chief Operating Officer, Chief Regulatory Officer, General Counsel, and Vice President of Market Regulation.

[15] *See supra* note 5.

validate the proposed adjustment, pursuant to proposed paragraph (c).

Proposed paragraph (c) provides that a trade adjustment shall only be made to the extent necessary to correct the Bona Fide Error (*i.e.,* to reflect the original terms of the order). The proposed paragraph continues by stating that prior to approving an adjustment, the Exchange shall validate that the proposed adjusted trade could have been executed in the Matching System at the time the trade was *initially* executed, in compliance with all applicable CHX and SEC rules. For instance, the validation process would require the Exchange to ensure that the proposed adjusted trade would not have improperly traded-through or ahead of interest resting on the Matching System (''CHX Book'') or a Protected Quotation of an external market in violation of Rule 611 of Regulation NMS.

Proposed paragraph (c) illustrates the benefit of a trade adjustment over a trade cancellation and the submission of an Error Correction Transaction.[16] Assuming that a corrective trade would qualify as an Error Correction Transaction and be exempt from the trade-through prohibition of Rule 611 of Regulation NMS, such a corrective trade would still be subject to the state of the CHX Book as of the time the corrective trade was submitted. However, a validated trade adjustment would allow the executing broker Participant to preserve the timestamp of the original trade. Allowing the executing broker Participant to choose a trade cancellation or adjustment would allow for greater flexibility in determining the best course of action to rectify Bona Fide Errors.

Proposed paragraph (d) clarifies that if the Exchange approves a request for a trade cancellation or adjustment, any corrective action(s) necessary to effectuate the cancellation or adjustment, including corrective entries into the Exchange's records and/or corrective clearing submissions to a Qualified Clearing Agency, shall be taken solely by the Exchange operations personnel. This provision serves as a contrast to proposed paragraph (b), which places the responsibility for satisfying the T+1 requirement upon the executing broker Participant that submitted the erroneous trade.

The following *Examples 1–3* illustrate how proposed Rule 9 would be applied under different scenarios.

Example 1. Assume that Broker A receives an order to buy 100,000 shares of security XYZ at $100.10/share. Assume that the Broker A wishes to match that order with a contra-side order that was placed with Broker A earlier that day. Assume that Broker A accurately conveys the terms of the cross order to Broker B, which is an executing broker Participant. However, assume that Broker B commits a good faith input error as to the price of the order and thus, an erroneous trade of 100,000 shares of security XYZ at $100.01 is executed on the Exchange.[17]

The price input error by Broker B would constitute a Bona Fide Error, pursuant to proposed Article 1, Rule 1(hh)(1) or (3), where the execution of the cross at the incorrect price is an ''inaccurate conveyance or execution of any term of an order, including, but not limited to, price'' and may also be the result of ''the incorrect entry of data into relevant systems.''

Moreover, if the parties to the erroneous trade wished to *cancel* the trade, Broker B would have to comply with the requirements of proposed Article 20, Rule 9(b) no later than 4:30 p.m. CST on T+1 or after T+1 with the approval of an officer of the Exchange. Specifically, pursuant to proposed paragraph (b)(1), Broker B must submit a Trade Error Report and a brief written request to cancel the erroneous trade. Also, pursuant to proposed paragraph (b)(2), Broker B must provide a brief explanation of the input error and produce documentation reflecting the original terms of the order. The documentation requirement could be satisfied, among other ways, by producing the internal order ticket from Broker A showing the price of $100.10 or a copy of a communication from Broker A to Broker B indicating the correct price and a timestamp prior to the CHX timestamp of the erroneous trade. In addition, pursuant to proposed paragraph (b)(3), Broker B would have to produce documentation evidencing consent to cancel the erroneous trade by the parties to the trade or, since Broker B did not interface directly with the parties to the erroneous trade, consent to cancel by Broker A, as authorized agent(s) of the parties to the trade.

Example 2. Assume the same as Example 1, except that the order price input error (*i.e.,* $100.01, instead of $100.10) was committed by Broker A as an authorized agent of the parties to the erroneous trade and not by Broker B. Assume, therefore, that Broker B received the order with the incorrect price and, in turn, submitted the cross order to the Matching System resulting in an erroneous trade.

In this Example, the Bona Fide Error could be subject to proposed Rule 9 because proposed paragraph .02 contemplates Bona Fide Errors committed by the ''customer of the Participant that submitted the erroneous trade.'' However, in requesting the trade cancellation, Broker B would be required to provide all of the information as required by proposed paragraph (b) in a manner similar to Example 1, except that in addition to identifying the price misconveyance and the source of the error as being Broker A, Broker B would have to produce documentation of the original terms of the order as relayed to Broker A from each of the parties to the erroneous trade. As a general rule, the documentation showing the correct order terms should be verifiable to an objective source. That is, if the Bona Fide Error was committed by the executing broker Participant, the documentation showing the correct terms should be from the Participant's customer. If the Bona Fide Error was committed by the customer of the Participant, then an internal order ticket or similar documentation showing the correct terms as related to the customer of the Participant, would suffice.

Example 3. Assume the same as Example 2, except that the parties to the erroneous trade wished to adjust the trade to comport it with the original terms of the order (*i.e.,* correct price of $100.10). Assume further that, at the time of the erroneous trade, the National Best Bid and Offer (''NBBO'') for security XYZ was $100.01 × $100.11 and the CHX Best Bid and Offer (''CHX BBO'') for security XYZ was at the NBBO. Assume also that the CHX best bid at $100.01 was for 100 shares and there are no undisplayed interests at or within the CHX BBO. In this case, like in Example 2, the executing broker Participant would have to satisfy the requirements of proposed paragraph (b).

In addition, pursuant to proposed paragraph (c), the Exchange would take the additional step of validating that the adjusted trade could have been executed in the Matching System at the time the erroneous trade was initially executed, in compliance with all applicable CHX and SEC rules. Thus, based on the aforementioned snapshot of the NBBO and the CHX BBO at the time of the erroneous trade, an adjustment of the price of the erroneous trade from $100.01 to the correct price of $100.10 would have complied with SEC and CHX rules, as of the time of the erroneous trade. Specifically, the adjusted trade would have complied

[16] *See supra* note 4.

[17] Assuming that the reference price for security XYZ is approximately $100.10 per share, the erroneous trade would not qualify for cancellation as a Clearly Erroneous Transaction because the erroneous price of $100.01 does not meet the 3% threshold. *See* CHX Article 20, Rule 10(c).

with Rule 611 of Regulation NMS in that it would not have constituted a trade-through of a Protected Quotation of an external market as the adjusted price of $100.10 would have been within the NBBO of $100.01 × $100.11 at the time of the erroneous trade. Moreover, the adjusted trade would have complied with Article 20, Rule 8 in that the adjusted trade would not have improperly traded-through or ahead of interest resting on the CHX Book as the adjusted price of $100.10 would have been within the CHX BBO of $100.01 × $100.11.[18]

As discussed above, Example 3 illustrates the primary benefit of a trade adjustment over a trade cancellation then corrective trade, which is to preserve the original timestamp of the trade. This is important because the NBBO and the CHX Book may have changed to the extent that a trade with the correct terms may no longer be executable. Even if the corrective trade qualifies as an Error Correction Transaction [19] and is thereby able to trade-through the NBBO, if a subsequent order were to have posted to the CHX Book after the erroneous trade executed at a price that was the same as or better than the corrective trade, the corrective trade would nevertheless be blocked by the CHX Book.[20] Trade adjustments avoid this problem by allowing the original trade to stand with adjustments to the trade to comport it to the original terms of the order, so long as the adjusted trade could be validated pursuant to proposed paragraph (c). Thus, the prevailing market and the state of the CHX Book as of the time of the adjustment become irrelevant.

The Exchange submits that allowing such adjustments of Bona Fide Error trades would not harm other market participants because the result of an adjusted trade is identical to the original trade having been executed correctly. Indeed, trade adjustments ensure that parties to a trade are not penalized for Bona Fide Errors committed by authorized agent(s) or the executing broker Participant that submitted the erroneous trade. Furthermore, the Exchange submits that Bona Fide Error trade adjustments would be beneficial to the market as a whole in that it would prevent the excessive reporting of trades to the Consolidated Tape.[21] When an erroneous trade is submitted, cancelled, then a corrective trade is submitted, the Consolidated Tape would reflect two order executions, thereby skewing the activity in that NMS stock. In contrast, a trade adjustment to the erroneous trade would result in only the original trade being reported. In addition, the Exchange notes that a trade adjustment would not harm other market participants because a trade adjustment is tantamount to the original trade having been made without Bona Fide Errors. That is, if the trade were adjusted to the correct terms, other market participants would be in the same position as if the trade had originally executed at the correct terms.

Finally, proposed paragraph (e) mirrors current Article 20, Rule 9(b)(5) which provides that failure to comply with the provisions of this Rule shall be considered conduct inconsistent with just and equitable principles of trade and a violation of Article 9, Rule 2.[22] As the Exchange intends for the functionality provided by proposed Rule 9 to be utilized sparingly, the Exchange will continue its current market surveillance procedures to reasonably ensure that both Bona Fide Error trade cancellations and adjustments are properly utilized from both a basis and frequency perspective.

Proposed Article 20, Rule 9A ''Error Correction Transactions''

Proposed Rule 9A adopts requirements for Error Correction Transactions (''ECT''), which are currently accepted by the Exchange, but the requirements of which are not detailed in the CHX rules.[23] The proposed language virtually mirrors key portions of the ''Order Exempting Certain Error Correction Transactions From Rule 611 of Regulation NMS Under the Securities Exchange Act of 1934'' (''ECT order'').[24]

Specifically, proposed paragraph (a) provides that a Participant may submit an ECT to remedy the execution of customer orders that have been placed in error, provided that the following requirements are satisfied:

(1) The erroneous transaction was the result of a ''Bona Fide Error,'' as defined under proposed Article 1, Rule 1(hh);

(2) The Bona Fide Error is evidenced by objective facts and circumstances and the Participant maintains documentation of such facts and circumstances;

(3) The Participant recorded the ECT in its error account;

(4) The Participant established, maintained, and enforced written policies and procedures that were reasonably designed to address the occurrence of errors and, in the event of an error, the use and terms of an ECT to correct the error in compliance with this Rule; and

(5) The Participant regularly surveiled to ascertain the effectiveness of its policies and procedures to address errors and transactions to correct errors and took prompt action to remedy deficiencies in such policies and procedures.

Proposed paragraph (b) states that an ECT may execute without the restrictions of the trade-through prohibition of Rule 611, provided that the ECT is marked with a special Bona Fide Error trade indicator.[25] Proposed paragraph (b) further states that this exemption applies only to the ECT itself and does not, for example, apply to any subsequent trades made by a Participant to eliminate a proprietary position connected with the ECT. Aside from the language requiring that ECTs be marked with a special trade indicator, the proposed language virtually mirrors language from the ECT order.

Similar to proposed Article 20, Rule 9(e), proposed paragraph (c) provides that failure to comply with the provisions of this Rule shall be considered conduct inconsistent with

[18] Current Article 20, Rule 8(d)(1) states that ''except for certain orders which shall be executed as described in Rule 8(e), below, an incoming order shall be matched against one or more orders in the Matching System, in the order of their ranking, at the price of each resting order, for the full amount of shares available at that price, or for the size of the incoming order, if smaller.''

[19] *See* Securities Exchange Act Release No. 55884 (June 8, 2007), 72 FR 32926 (June 14, 2007) (Order Exempting Certain Error Correction Transactions From Rule 611 of Regulation NMS Under the Securities Exchange Act of 1934).

[20] For instance, where the order posted to the CHX Book after the erroneous trade and the corrective trade are priced the same, a corrective trade that qualifies for special handling as Cross With Size would execute ahead of such resting orders at the same price. *See* Article 20, Rule 2(g)(1).

[21] The Exchange does not submit that ''excessive'' reporting to the tape would reflect inaccurate information. Rather, the Exchange believes that if trades were allowed to be adjusted under the circumstances proposed by this proposed rule filing, the tape could more efficiently represent market activity (*e.g.,* reporting the initial trade and an adjustment to that trade, as opposed to reporting the initial trade, plus a cancellation of that trade, and a replacement trade).

[22] CHX Article 9, Rule 2 (Just and Equitable Trade Principles) states as follows:

No Participant, Participant Firm or partner, officer, director or registered employee of a Participant Firm shall engage in conduct or proceeding inconsistent with just and equitable principles of trade. The willful violation of any provision of the Exchange Act or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

[23] The Exchange currently accepts ECTs, provided that, *inter alia,* the ECT is marked by a special Bone Fide Error trade indicator and the Participant submits a Trade Error Report to the Exchange.

[24] *See supra* note 19.

[25] *See supra* note 23.

just and equitable principles of trade and a violation of Article 9, Rule 2.[26]

Within the context of the proposed CHX trade cancellation and adjustment matrix, proposed Rule 9A addresses a few specific situations. First, ECTs are typically used to submit corrective trades after a trade based on Bona Fide Error had been cancelled or to submit a trade where the original order was never submitted (*i.e.,* a ''missed market'' situation).[27] ECTs can also provide a corrective remedy where there is a Bona Fide Error trade, as defined under proposed Article 1, Rule 1(hh), but a trade cancellation or adjustment pursuant to proposed Rule 9 is not possible, due to the fact that there is not unanimous consent of all parties to the trade to cancel or adjust (*e.g.,* Bona Fide Error was committed by the executing broker Participant with respect to a single-sided order). In such a case, the erroneous trade would be taken into the error account of the executing broker Participant, as opposed to being cancelled. However, if the erroneous trade were cancelled as a Clearly Erroneous Transaction [28] without the unanimous consent of all parties to the trade, an ECT could be affected without the executing broker Participant having to take the erroneous trade into its error account. Thus, proposed Rule 9A, read together with current Article 20, Rule 9 and Rule 10, contemplates a wide array of remedies to correct Bona Fide or Obvious Errors.

Proposed Article 20, Rule 11 ''Cancellation or Adjustment of Stock Leg Trades''

The Exchange proposes to adopt Article 20, Rule 11 (''Cancellation or Adjustment of Stock Leg Trades'') to expand and clarify current Article 20, Rule 9(b), which outlines the requirements for the cancellation of the stock leg of Stock-Option orders. In addition to adopting much of current Article 20, Rule 9(b), proposed Rule 11 expands the circumstances under which stock leg trades may be cancelled, adopts new requirements to allow for the adjustment of stock leg trades and includes Stock-Future orders within the purview of the proposed Rule.

Proposed Rule 11(a) adopts current Article 20, Rule 9(b)(6) and provides a general overview of the scope of the proposed Rule. Specifically, it states that unless otherwise expressly prohibited by the Exchange's rules, a trade representing the stock leg of a Stock-Option combination order, as defined under proposed Article 1, Rule 1(ii) or a Stock Future combination order, as defined under Article 1, Rule 1(jj), may be subject to cancellation or adjustment by the Exchange pursuant to proposed Rule 11, if the stock leg trade was marked by a special trade indicator when it was originally submitted to the Matching System.[29] The proposed paragraph further clarifies that if the stock leg trade was not originally marked by a special trade indicator, the trade shall not be eligible for cancellation or adjustment, notwithstanding compliance with the other requirements of this Rule.

Proposed Article 1, Rule 1(ii) provides a definition for ''Stock-Option'' combination orders. Specifically, the proposed definition of ''Stock-Option'' order simplifies current Article 20, Rule 9(b)(2) [30] and provides that ''Stock-Option'' is a combination order where at least one component is a cross order for a stated number of units of an underlying or related security coupled with the purchase or sale of options contract(s) on the opposite side of the market representing at least the same number of units as the underlying or related security portion of the order. The Exchange submits that this simplified definition encompasses the hedging scenarios described in current Article 20, Rule 9(b)(2)(i) and (ii), as illustrated in the examples below.

The Exchange notes that all cross orders marked as Qualified Contingent Trades (''QCTs'') [31] received by the Matching System would qualify as a Stock-Option or Stock-Future order and thus be eligible for cancellation or adjustment pursuant to proposed Rule 11.[32] However, it is important to note that not every Stock-Option or Stock-Future order would qualify as a QCT because the definition of Stock-Option/Stock-Future does not require the contemporaneous or near contemporaneous execution of the different components. Therefore, maintaining the distinction between QCT and Stock-Option/Stock-Future orders is important, in light of the fact that a stock leg trade that qualifies as QCT is exempt from Rule 611(a) of Regulation NMS, whereas a stock leg trade that is part of a Stock-Option or Stock-Future combination order may be cancelled or adjusted pursuant to proposed Rule 11.

The following *Examples 1–3* illustrate which combination orders would comport with the proposed definition of ''Stock-Option'' orders.

Example 1. Assume that a combination order is presented as follows and the contra-parties to the stock and options legs are the same:

Buy 1,000,000 shares of XYZ
Sell 10,000 XYZ Jan 50 call options

In this Example, the stock position on the long side of the market is hedged on a share-by-share basis by the options position on the short side of the market, because the stock position represents the same number of units as the options position (*i.e.,* 1,000,000 shares of XYZ on the long side against 10,000 XYZ call options representing 1,000,000 shares of XYZ on the short side). Thus, this combination order is a ''Stock-Option'' order as defined under proposed Article 1, Rule 1(ii), because the short side call options represent ''at least the same number of units as the underlying or related security portion of the order.''

[26] *See supra* note 22.

[27] The Exchange notes that ''absent a bona fide error as defined above, the exemption does not apply to a broker-dealer's mere failure to execute a not-held order in accordance with a customer's expectations.'' Securities Exchange Act Release No. 55884 (June 8, 2007), 72 FR 32926, 32927 (June 14, 2007), note 14.

[28] *See* CHX Article 20, Rule 10.

[29] Current Article 20, Rule 9(b)(6) requires ''any transactions cancelled pursuant to the provisions of this section must be identified by a special trade indicator.''

The purpose of the special trade indicator is to mark a stock leg trade as being part of a Stock-Option order and consequently notifies the market after execution that the trade may be cancelled, as the trade is contingent upon the execution of non-stock legs that comprise the total Stock-Option combination order.

[30] Current Article 20, Rule 9(b)(2) states as follows:

For purposes of this Rule, a 'stock-option order' is an order to buy or sell a stated number of units of an underlying or a related security coupled with either (i) the purchase or sale of option contract(s) on the opposite side of the market representing either the same number of units of the underlying or related security or the number of units of the underlying security necessary to create a delta-neutral or delta-hedged position or (ii) the purchase or sale of an equal number of put and call option contracts, each having the same exercise price, expiration date and each representing the same number of units of stock as, and on the opposite side of the market from, the underlying or related security portion of the order.

[31] *See* Securities Exchange Act Release No. 54389 (August 31, 2006), 71 FR 52829 (September 7, 2006) (''Order Granting an Exemption for Qualified Contingent Trades From Rule 611(a) of Regulation NMS Under the Securities Exchange Act of 1934''); see also Securities Exchange Act Release No. 57620 (April 4, 2008), 73 FR 19271 (April 4, 2008) (''Order Modifying the Exemption for Qualified Contingent Trades From Rule 611(a) of Regulation NMS Under the Securities Exchange Act of 1934''); *see also* Article 1, Rule 2(b)(2)(E).

[32] The QCT requirement that ''the Exempted NMS Stock Transaction is fully hedged (without regard to any prior existing position) as a result of the other component of the contingent trade'' is similar to the proposed requirement for Stock-Option/Stock-Future orders that the stock leg trade be couple with ''options contract(s) on the opposite side of the market representing at least the same number of units as the underlying or related security portion of the order.'' *See* CHX Article 1, Rule 2(b)(2)(E).

Example 2. Assume that a combination order is presented as follows and the contra-parties to the stock and options legs are the same:

Buy 470,000 shares of XYZ
Sell 10,000 XYZ Jan 50 call options

Assume further that the call options have a delta value of 0.47. In this Example, the stock position on the long side of the market is hedged on a share-by-share basis by the options position on the short side of the market, because the stock position represents fewer units than the options position (*i.e.,* 470,000 shares of XYZ on the long side against 10,000 XYZ call options representing 1,000,000 shares of XYZ on the short side). Thus, this combination order is a ''Stock-Option'' order as defined under proposed Article 1, Rule 1(ii), because the short side call options represent ''at least the same number of units as the underlying or related security portion of the order.'' Moreover, this Example illustrates that a delta-neutral hedge will fall within the proposed definition. That is, since a delta value can never exceed 1, a delta-neutral hedge will never result in a stock position being less than hedged on a share-by-share basis by the options position.

Example 3. Assume that a combination order is presented as follows and the contra-parties to the stock and options legs are the same:

Buy 2,000,000 shares of XYZ
Sell 10,000 XYZ Jan 50 call options

In this Example, the stock position on the long side of the market is not hedged on a share-by-share basis by the options position on the short side of the market, because the stock position represents a greater number of units than the options position (*i.e.,* 2,000,000 shares of XYZ on the long side against 10,000 XYZ call options representing 1,000,000 shares of XYZ on the short side). Thus, this combination order is not a ''Stock-Option'' order as defined under proposed Article 1, Rule 1(ii), because the short side call options do not represent ''at least the same number of units as the underlying or related security portion of the order.''

In sum, Examples 1–3 illustrate that if the long (short) stock position is hedged on at least a share-by-share basis by the short (long) options position(s), the combination order will meet the proposed definition of ''Stock-Option.'' Moreover, the following *Examples 4–7* illustrate situations where there are more than one options positions, such as the scenario described under current Article 20, Rule 9(b)(2)(ii) and how such multiple options positions would fit under the proposed definition of ''Stock-Option'' order.

Example 4. Assume that a combination order is presented as follows and the contra-parties to the stock and options legs are the same:

Buy 1,000,000 shares of XYZ
Sell 10,000 XYZ Jan 50 call options
Buy 10,000 XYZ Jan 50 put options

This is an example of the type of order contemplated by current Article 20, Rule 9(b)(2)(ii). That is, the positions in this Example 4 represent the purchase or sale of an equal number of put and call option contracts (*i.e.,* 10,000 contracts each), each having the same exercise price (*i.e.,* $50.00), expiration date (*i.e.,* January) and each representing the same number of units of stock as, and on the opposite side of the market from, the underlying or related security portion of the order (*i.e.,* each option represents 1,000,000 shares on the short side of the market opposite of the 1,000,000 shares on the long side market).

This order fits within the proposed definition of ''Stock-Option'' because each one of the options legs are on the opposite side of the market from the stock leg and each represent ''at least the same number of units as the underlying or related security portion of the order.''

Example 5. Assume that a combination order is presented as follows and the contra-parties to the stock and options legs are the same:

Buy 1,000,000 shares of XYZ
Sell 6,000 XYZ Jan 50 call options
Buy 4,000 XYZ Jan 50 put options

This order also fits within the proposed definition of ''Stock-Option'' because the stock position on the long side of the market is hedged on a share-by-share basis by the sum of the two options position on the short side of the market, because the stock position represents the same number of units as the options position (*i.e.,* buy 1,000,000 shares of XYZ on the long side against sell 6,000 XYZ call options and buy 4,000 XYZ put options, together representing 1,000,000 shares of XYZ on the short side). Thus, this combination order is a ''Stock-Option'' order as defined under proposed Article 1, Rule 1(ii), because the short side call and put options together represent ''at least the same number of units as the underlying or related security portion of the order.''

Another way to visualize this trade is to break up the order into two separate Stock-Option orders:

Stock-Option Order #1	Stock-Option Order #2
Buy 600,000 shares of XYZ.	Buy 400,000 shares of XYZ.
Sell 6,000 XYZ Jan 50 call options.	Buy 4,000 XYZ Jan 50 put options.

Each one of the stock leg components are hedged on a share-by-share basis by options contracts on the opposite side of the market representing exactly the same number of shares as the stock leg.

Example 6. Assume that a combination order is presented as follows and the contra-parties to the stock and options legs are the same:

Buy 1,000,000 shares of XYZ
Sell 5,000 XYZ Jan 50 call options
Sell 5,000 XYZ Jan 50 put options

In this Example, the stock position and the XYZ Jan 50 put options are on the long side of the market, while the XYZ Jan 50 call is on the short side of the market. Since the proposed definition of ''Stock-Option'' is only concerned about the stock position being hedged by options on the opposite side of the market, and not additional options positions on the same side of the market as the stock position, any options positions on the same side of the market as the stock position would be ignored. After excluding the XYZ Jan 50 put options from the analysis, we are left with a stock position on the long side that is not hedged on a share-by-share basis by the options position on the short side, because the stock position represents a greater number of units than the options position (*i.e.,* buy 1,000,000 shares of XYZ on the long side against sell 5,000 XYZ call options representing 500,000 shares of XYZ on the short side). Thus, this combination order is not a ''Stock-Option'' order as defined under proposed Article 1, Rule 1(ii), because the short side call options do not represent ''at least the same number of units as the underlying or related security portion of the order.''

Example 7. Assume the same as Example 6, except that the call options on the short side of the market were for 20,000 contracts representing 2,000,000 shares of XYZ. As in Example 6, the put options on the long side of the market would be ignored. We are then left with a stock position on the long side that is smaller than the call options position on the short side (*i.e.,* buy 1,000,000 shares of XYZ on the long side against 20,000 XYZ call options representing 2,000,000 shares of XYZ on the short side). Thus, this combination order is a ''Stock-Option'' order as defined under proposed Article 1, Rule 1(ii), because the short side call options represent ''at least the same number of units as the underlying or related security portion of the order.''

With respect to the proposed definition of ''Stock-Future'' order, proposed Article 1, Rule 1(jj) provides that it is a combination order where at least one component is a cross order for a stated number of units of an underlying or a related security coupled with the purchase or sale of futures contract(s) on the opposite side of the market representing at least the same number of units of the underlying or related security portion of the order.[33] Similar to the proposed definition for ''Stock-Option'' orders, this definition establishes a bright-line requirement for the size of the futures transaction, so as to prevent misuse of this proposed Rule (*i.e.,* the use of *de minimis* amount of future contracts to allow a stock order to be subject to cancellation or adjustment). Given that Stock-Future orders can also be QCTs, the Exchange submits that making the definitions of ''Stock-Option'' and ''Stock-Future'' orders nearly identical is appropriate.

Cancellation of Stock Leg Trades

Proposed Rule 11(b) outlines the requirements for the requests to cancel a stock leg trade. Specifically, paragraph (b)(1) incorporates and expands the first half of current Article 20, Rule 9(b)(1),[34] and provides that the Exchange may approve a request to cancel a stock leg trade that was originally marked by a special trade indicator and take the corrective action(s) necessary to effectuate such a cancellation, provided that the following items are submitted to the Exchange, in a form prescribed by the Exchange, by the Participant that submitted the stock leg trade. It further provides that the requirements of this paragraph (b) must be complied with to the satisfaction of the Exchange, before a stock leg trade cancellation pursuant to this Rule may be approved or any corrective action may be taken. In addition, the Exchange shall have sole discretion in determining whether the requirements of this Rule have been satisfied. Thereunder, proposed subparagraphs (A)–(C) require the following:

(A) *Timely written request.* The Participant that submitted the stock leg trade shall submit a written request for cancellation, including all information and supporting documentation required by this Rule, no later than 4:30 p.m. CST on T+1. The Exchange will retain a copy of the written request, information, and supporting documentation. In extraordinary circumstances, a cancellation may be requested and effected after T+1, with the approval of an officer of the Exchange;

(B) *Qualified Cancellation Basis.* The Participant that submitted the stock leg trade shall identify the Qualified Cancellation Basis, as defined under proposed paragraph (b)(2). The Participant shall also provide and maintain supporting documentation showing the objective facts and circumstances supporting the Qualified Cancellation Basis; and

(C) *All parties consent.* The Exchange shall verify that the cancellation is requested by all parties involved in the stock leg trade (or by an authorized agent of those parties). The Participant that submitted the stock leg trade shall provide supporting documentation evidencing this consent.

Similar to proposed Rule 9(b)(1), proposed subparagraph (A) sets a time limit for requests to cancel a stock leg trade of a Stock-Option/Stock-Future order. The time requirement is short enough to encourage quick resolution, while being long enough to accommodate unforeseen circumstances. Thus, similar to proposed Rule 9(b)(1), the Exchange will not consider any request to cancel a stock leg trade, much less take any corrective action to effectuate such a cancellation, until all of the requirements of proposed Rule 11 are satisfied.

Similar to proposed Rule 9(b)(2), proposed subparagraph (B) requires the Participant that submitted the stock leg trade to identify the specific reason for the requested cancellation, which in the context of Stock-Option/Stock-Future combination orders would at least be one of the ''Qualified Cancellation Basis,'' as discussed in detail below. Moreover, like proposed Rule 9(b)(2), the Participant that submitted the stock leg trade is responsible for providing all documentation that supports the Qualified Cancellation Basis. For instance, if the reason for the stock leg trade cancellation is that the non-stock leg executed at a price other than what was originally agreed, the Participant that submitted the stock leg trade would have to produce documentation reflecting the original non-stock leg terms and a copy of the original order ticket that reflects the non-stock leg trade as actually executed.

Similar to proposed Rule 9(b)(3), proposed subparagraph (C) requires the Exchange to verify that the request to cancel the stock leg trade is consented to by the parties to the stock leg trade or by an authorized agent(s) of the parties. However, the Participant that submitted the stock leg trade must provide the supporting documentation evidencing this consent to cancel (*e.g.,* email or instant message) from either the parties to the trade or by an authorized agent of the parties.

As referred to in proposed Rule 11(b)(1)(B) above, proposed Rule 11(b)(2) lists the ''Qualified Cancellation Basis'' as follows:

(A) A non-stock leg executed at a price/quantity or was adjusted to a price/quantity other than the price/quantity originally agreed upon by all of the parties to the Stock-Option or Stock-Future order;

(B) A non-stock leg could not be executed; or

(C) A non-stock leg was cancelled by the exchange on which it was executed.

While proposed subparagraph (C) substantively mirrors current Article 20, Rule 9(b)(1)(ii), proposed subparagraphs (A) and (B) expands the permissible circumstances where a stock leg trade may be cancelled.

Proposed subparagraph (A) is based on current Article 20, Rule 9(b)(1)(i), but expands its scope. Specifically, proposed subparagraph (A) eliminates the overly narrow reference to ''market conditions'' and includes execution of the non-stock leg at a size other than what was originally agreed as a basis to cancellation of the stock leg. That is, in addition to situations where market conditions prevent the execution of the non-stock leg at the originally agreed price (*e.g.,* NBBO changes), the proposed subparagraph (A) contemplates situations where the parties voluntarily adjust the terms of non-stock leg trade or modify the terms of the non-stock leg order prior to execution, with the intention of modifying the original stock leg terms. If all of the components are executed at the modified terms, there would be no need to cancel trades. However, given the latency inherent in the Stock-Option/Stock-Future order handling and execution process,[35] it is frequently the

[33] For example, a trade on the CHX in the SPDR S&P 500 ETF Trust (symbol SPY) may be related to a transaction in an S&P 500 futures contract.

[34] Current CHX Article 20, Rule 9(b)(1) states as follows:

Unless otherwise expressly permitted by the Exchange's rules, a trade representing the execution of the stock leg of a stock-option order may be cancelled at the request of all Participants that are parties to that trade if (i) market conditions in any of the non-Exchange market(s) prevent the execution of the option leg(s) at the price agreed upon by the parties to the options leg, or (ii) the options leg(s) is cancelled by the exchange on which it was executed.

[35] When parties to a Stock-Option/Stock-Future order agree to the terms, the individual components are virtually never executed simultaneously, due to the fact that derivative legs and stock legs are executed on different venues. Thus, the order packaging process frequently involves numerous brokers relaying order instructions for component orders that are to be executed at different venues. In the situation where a Stock-Option order originates on the floor of an options exchange or a Stock-Future order originates on the floor of a

case that modification instructions fail to reach the Participant that submitted the stock leg trade on the Exchange, prior to the stock leg executing at the original terms.

For instance, a voluntary modification of the terms of a Stock-Option order may arise if one or more parties to the order withdrew from the order prior to execution of any components. In such an instance, the remaining parties would have to either cancel the entire Stock-Option order or attempt to modify the terms of the order to compensate for the lost parties. If the parties chose to attempt to modify the terms of the Stock-Option order, there may be a situation where the non-stock leg would execute at the modified terms, but the stock leg trade would execute at the original terms, before the modified stock leg terms were received by the Participant that submitted the stock leg trade. Thus, the stock leg trade would likely be inadequately hedged [36] by the options position. In the worst case scenario, the stock leg may have traded-through a Protected Quotation without being ''fully hedged,'' as required by the QCT exemption.[37] In such a case, the parties may wish to either adjust the stock leg trade, pursuant to proposed Article 20, Rule 11(c), as discussed in detail below, or simply cancel the original stock leg trade and replace the trade with a stock leg trade that is adequately hedged by the modified non-stock leg trade.[38] Thus, by expanding current Article 20, Rule 9(b)(1)(i) to include all situations where a non-stock leg executed at a price/quantity other than what was originally agreed, the communication latency issues can be effectively mitigated and market participants can be protected from being penalized for engaging in *bona fide* market activity.

Proposed subparagraph (B) adopts a new Qualified Cancellation Basis where a stock leg trade may be cancelled if the non-stock leg was never executed. There are numerous reasons why a non-stock leg trade may not be executed. For instance, market conditions may block the execution of an options leg at the originally agreed price, and instead of executing at a price other than what was originally agreed, the parties may simply cancel the non-stock leg order. Also, one or more parties to a Stock-Option/Stock-Future order may decide not to participate in the Stock-Option order prior to any of the component orders being executed. In this case, instead of trying to modify the terms of the Stock-Option order to compensate for the lost parties, as discussed above, the remaining parties may decide that it would be best to cancel the entire order. If the parties decide to cancel the Stock-Option order, the cancel messages may reach the respective executing brokers in time, thus obviating the need to cancel trades. However, due to the inherent communication latency,[39] it is frequently the case that the non-stock leg order is cancelled prior to execution, but the cancel message does not reach the Exchange prior to the stock leg being executed. In such a situation, it would be patently unfair to require the parties to the Stock-Option/Stock-Future order to maintain a stock position that is no longer hedged by a non-stock position, especially if the stock leg relied on the QCT exemption to trade-through a Protected Quotation of an external market.

Moreover, the Exchange submits that any potential abuse of proposed subparagraph (B) is reasonably eliminated by the requirement that *all* parties to the Stock-Option order consent to the stock leg trade cancellation. Thus, since no one contra-party may act unilaterally to cancel a trade, this would prevent any one contra-party from cancelling a stock leg trade where stock prices or options prices moved in favor of that party. It logically flows that if prices move in favor of one party, the prices have moved to disadvantage of the contra-party. Under such circumstances, the contra-party would never agree to a stock leg trade cancellation.

The Exchange submits that the proposed Qualified Cancellation Bases, when considered as a whole, adequately address the latency issues that affect the Stock-Option/Stock-Future order packaging process. By expanding the permissible bases for cancelling stock leg trades, the problems arising from these latency issues can be resolved by allowing market participants to step away from unwanted stock positions when certain contingencies are not realized.

Adjustments of Stock Leg Trades

The Exchange submits that when a non-stock leg executes at different terms than originally agreed or is adjusted by the exchange, it may be more appropriate to permit the adjustment of the stock leg trade to maintain the original aggregate cash flow [40] or original hedge ratio of the Stock-Option or Stock-Future order that was agreed upon by all of the parties, as opposed to cancelling the stock leg trade and requiring the parties to attempt to execute the entire package again. So long as the adjustment is consistent with original intent of the parties that can be reasonably ascertained, the Exchange submits that allowing adjustments can prove to be a valuable tool in promoting order flow to the Exchange and preventing the excessive reporting of activity to the tape.[41]

Proposed paragraph (c) adopts new requirements to allow for the adjustment of a stock leg trade that is a component of a Stock-Option/Stock-Future order under specified circumstances. The format of proposed paragraph (c) is modeled on proposed paragraph (b), with additional substance to address the added complexity of adjusting trades. Similar to proposed paragraph (b)(1), proposed paragraph (c)(1) provides that the Exchange may approve a request to adjust a stock leg trade that was originally marked by a special trade indicator and take the corrective action(s) necessary to effectuate such an adjustment, provided that the following items are submitted to the Exchange, in a form prescribed by the Exchange, by the Participant that submitted the stock leg trade. It further states that the requirements of this proposed paragraph (c) must be complied with, to the satisfaction of the Exchange, *before* a stock leg trade adjustment pursuant to this Rule may be approved or any corrective action may be taken. Thereunder, proposed subparagraphs (A)–(D) require the following:

(A) *Timely written request.* The Participant that submitted the stock leg trade shall submit a written request for adjustment, including all information and supporting documentation required by this Rule, no later than 4:30 p.m. CST

futures exchange, the relaying of stock leg order information will likely go from the floor brokers to an inter-dealer broker, who in turn will relay the information to an executing broker Participant. In such a case, there will be an inherent latency in communication in the process.

[36] An ''inadequate'' hedge means a hedge ratio that deviates from what has been agreed by the parties to the Stock-Option/Stock-Future order or a hedge that is not a ''fully hedged'' position, as required and defined by the QCT exemption. *See supra* note 31.

[37] *See supra* note 31.

[38] The parties may decide that it would be more desirable to cancel the stock leg trade, given the additional requirements that must be met for a trade adjustment to be approved pursuant to proposed Article 20, Rule 11(c), especially if the replacement stock leg trade would not trade-through a Protected Quotation of an external market.

[39] *See supra* note 35.

[40] The ''original aggregate cash flow'' of a Stock-Option or Stock Future order is the absolute value of the difference between the cash flow of the proposed stock leg trade and the proposed non-stock leg trade had the Stock-Option or Stock-Future order been executed as originally intended. *See infra* Example 8.

[41] *See supra* note 21.

on T+1. The Exchange will retain a copy of the written request, information, and supporting documentation. In extraordinary circumstances, an adjustment may be requested and effected after T+1, with the approval of an officer of the Exchange;

(B) *Qualified Adjustment Basis.* The Participant that submitted the stock leg trade shall identify the Qualified Adjustment Basis, as defined under proposed paragraph (c)(2). The Participant shall also provide and maintain supporting documentation showing the objective facts and circumstances supporting the Qualified Adjustment Basis;

(C) *All parties consent.* The Exchange shall verify that the adjustment is requested by all parties involved in the stock leg trade (or by an authorized agent of those parties). The Participant that submitted the stock leg trade shall provide supporting documentation evidencing this consent; and

(D) *Additional Documentation.* The Participant that submitted the stock leg trade shall submit a proposed Adjusted Stock Price or Adjusted Stock Quantity, as detailed under proposed paragraph (c)(3).

Similar to proposed paragraph (b)(1)(A)–(C), proposed subparagraphs (c)(1)(A)–(C) establishes time, basis, consent, and documentation requirements for proposed stock leg trade adjustments. Proposed subparagraph (D) establishes an additional documentation requirement for proposed stock leg trade adjustments that requires the Participant that submitted the stock leg trade to provide certain information and calculations to show that the proposed adjustment are necessary and appropriate (*i.e.,* Adjusted Stock Price for price adjustments and Adjusted Stock Quantity for quantity adjustments) and comport with the requirements of proposed paragraph (c)(3).

As referred to in proposed Rule 11(c)(1)(B) above, proposed paragraph (c)(2) provides that a ''Qualified Adjustment Basis'' exists if a non-stock leg executed at a price/quantity or was adjusted to a price/quantity other than the price/quantity originally agreed upon by all of the parties to the Stock-Option or Stock-Future order. Proposed paragraph (c)(2) is identical to proposed paragraph (b)(2)(A). If the non-stock leg were to execute or be adjusted to price/quantity other than what was originally agreed, the parties to the stock leg trade would have the choice of either cancelling the stock leg trade or adjusting the stock leg trade to match the original aggregate cash flow or the original hedge ratio of the Stock-Option or Stock-Future order. Adjustments under such circumstances would obviate the need to cancel component trades that have been properly executed and would be a more efficient use of market resources. Moreover, adjustments would also have the additional benefit of avoiding excessive reporting to the tape.[42]

In order to reasonably ensure that adjustments to the stock leg trade are made consistently and comport to the original intent of the parties, a detailed methodology for determining and verifying exact adjusted terms is essential. To this end, proposed paragraph (c)(3) provides that the Participant that submitted the stock leg trade may request only one of the following adjustments per Stock-Option or Stock-Future order. Moreover, pursuant to proposed paragraph (c)(1)(D), the Participant shall provide the applicable information and calculations to the Exchange in a form prescribed by the Exchange.

Proposed subparagraph (A) details the necessary calculations for Adjusted Stock Price, where a non-stock leg executed at a price or was adjusted to a price other than the price originally agreed upon by all of the parties to the Stock-Option or Stock-Future order and the parties wish to maintain the original aggregate cash flow of the Stock-Option or Stock-Future order. Thereunder, subparagraphs (A)(i)–(iv) require the Participant that submitted the stock leg trade to submit:

(i) the aggregate cash flow of the Stock-Option or Stock-Future order based on trade prices had it been fully executed at the original terms agreed upon by all of the parties to the Stock-Option or Stock-Future order, prior to any component trade having been executed;

(ii) the actual aggregate cash flow of the executed non-stock leg(s);

(iii) the Comparable Stock Price (''CSP'') for the stock leg which would result in exactly the same aggregate cash flow as indicated under subparagraph (i);

(iv) the proposed Adjusted Stock Price (''ASP'') that comports with the following formula:

$$(CSP - \$0.015) \leq ASP \leq (CSP + \$0.015)$$

The following *Examples 8 and 9* illustrate how the requirements of proposed subparagraph (A) could be met.

Example 8. Assume that the current market value for XYZ Jan 50 call options is $4.50/share, the call options have a delta of 0.47, and the current market value for security XYZ is $50.00. Assume that Floor Broker A and Floor Broker B agree to a Buy-Write Stock-Option combination order and wish to employ a delta-neutral hedge (*i.e.,* hedge ratio of 0.47) against the options positions. Specifically, the parties agree that Floor Broker A will buy 10,000 XYZ Jan 50 calls from Floor Broker B for $4.50 per share and Floor Broker A will sell to Floor Broker B 470,000 shares of XYZ at $50.00/share. Assume that the parties are on the floor of an options exchange and forward the terms of the stock leg order to an inter-dealer broker, who then forwards the order to an executing broker Participant on the Exchange.

Assume that within a few seconds of the stock order being relayed to the interdealer broker, market conditions prevent the execution of the options leg at $4.50/share (*e.g.,* the NBBO for options contract changed from $4.45 × $4.55 to $4.35 × $4.40).[43] Due to time and customer considerations, the parties agree to execute the options leg at the NBO of $4.40/share. At nearly the same time, the parties relay the new stock leg terms to the interdealer broker for transmission to the executing broker Participant. However, before the message reaches the Exchange Participant, the stock leg trade was already executed on the Exchange at the original terms of 470,000 shares of XYZ at $50.00/share.

The Participant that submitted the stock leg trade (*i.e.,* the executing broker Participant) now wishes to adjust only the price of the stock leg trade to ensure that the aggregate cash flow remains the same as originally agreed.[44] In addition to meeting the requirements of proposed paragraph (c)(1) and (c)(2), the Participant would have to submit the following documentation and calculations:

Pursuant to proposed subparagraph (A)(i), the Participant would have to provide documentation to the Exchange that shows the aggregate cash flow for the Stock-Option order as originally agreed. Specifically, the Participant would have to show that the cash flow

[42] *Id.*

[43] The Exchange notes that although market conditions preventing the execution of the non-stock leg at a price other than what was originally agreed is one example of a Qualified Adjustment Basis, proposed Rule 11(c)(2) contemplates any situation where the non-stock leg executed at a price other than what was originally agreed, provided that the other requirements of proposed Rule 11 are met.

[44] If the executing broker Participant wished to adjust the quantity of the stock leg trade to maintain a delta-neutral hedge based on the new delta at $4.40 per share, the executing broker Participant would have satisfy the requirements of proposed subparagraph (C), which is discussed in detail below.

for the options leg had it executed at the original terms to be *$4,500,000* (*i.e.,* where 10,000 contracts = 1,000,000 underlying shares; 1,000,000 shares × $4.50/share = $4,500,000 premium to be paid by Floor Broker A to Floor Broker B) and the cash flow for the stock leg trade had it executed at the original terms to be *$23,500,000* (*i.e.,* 470,000 shares × $50.00 per share = $23,500,000 paid by Floor Broker B to Floor Broker A). Thus, the total aggregate cash flow of the Stock-Option order had it executed at the original terms would have been *$19,000,000* (*i.e.,* the absolute value of the difference between the cash flows for the options leg and the stock leg had they executed at the original terms);

Pursuant to proposed subparagraph (A)(ii), the Participant would have to provide documentation to the Exchange that states that the actual aggregate cash flow for the options leg as actually executed to have been *$4,400,000* (*i.e.,* 10,000 contracts = 1,000,000 underlying shares; 1,000,000 shares × $4.40/share = $4,400,000 to be paid by Floor Broker A to Floor Broker B); and

Pursuant to proposed subparagraph (A)(iii), the Participant would have to submit a Comparable Stock Price (''CSP'') that would result in exactly the same aggregate cash flow as calculated pursuant to proposed subparagraph (A)(i) of *$19,000,000.* Thus, the proposed CSP would be calculated pursuant to the following formula:

$$\text{CSP} = \frac{\text{(Proposed Aggregate Cash Flow} - \text{Actual Cash Flow of Options Leg)}}{\text{Number of Shares Actually Executed}}$$

Pursuant to this formula, the CSP is *$49.787234* (*i.e.,* $19,000,000–$4,400,000)/470,000 shares).

Moreover, the following Example 9 illustrates how proposed subparagraph (A)(iv) would be applied.

Example 9. Assume the same as Example 8, except that Floor Broker A maintains that the Adjusted Stock Price (''ASP'') should be $49.79 by rounding up to the nearest cent and Floor Broker B maintains that the ASP should be $49.78 by rounding down to the nearest cent.[45]

Proposed subparagraph (A)(iv) provides latitude in determining the actual ASP, by allowing the parties to reconcile rounding discrepancies. Thus, pursuant to proposed subparagraph (A)(iv), the permissible range for an ASP would be plus or minus $0.015 from $49.787234, which is $49.772234–$49.802234. Given this permissible range, an equitable remedy for the discrepancy would be for Floor Broker A and Floor Broker B to split the difference in CSPs and meet halfway at $49.785. Since the ASP of $49.785 is within the range of the parameters based on a CSP of $49.78 and $49.79, the agreed ASP of $49.785 may be accepted by the Exchange, so long as the other requirements of proposed Rule 11 are satisfied.[46]

Proposed subparagraph (B) details the necessary calculations for Adjusted Stock Quantity, where a non-stock leg executed at a quantity or was adjusted to a quantity other than the quantity originally agreed upon by all of the parties to the Stock-Option or Stock-Future order. Thereunder, proposed subparagraphs (B)(i)–(iii) require the Participant that submitted the stock leg trade to submit:

(i) the original hedge ratio agreed upon by all the parties to the Stock-Option or Stock-Future order, prior to any component trade having been executed;

(ii) the proposed Expected Stock Quantity (''ESQ'') that maintains the original hedge ratio; and

(iii) the proposed Adjusted Stock Quantity (''ASQ'') that comports with the following formula:

$98.5\%\ \text{ESQ} \leq \text{ASQ} \leq 101.5\%\ \text{ESQ}$

The following *Example 10* illustrates how the requirements of proposed subparagraph (B) could be met.

Example 10. Assume that the current market value for XYZ Jan 50 call options is $4.50/share, the call options have a delta value of 0.47, and the current market value for security XYZ is $50.00. Assume that Floor Broker C, Floor Broker D, and Floor Broker E agree to a Buy-Write Stock-Option combination order and wish to employ a delta-neutral hedge (*i.e.,* hedge ratio of 0.47) against the options position. Specifically, the parties agree that Floor Brokers C and D will buy 10,000 XYZ Jan 50 calls from Floor Broker E for $4.50/share, where Floor Broker C will buy 7,000 contracts and Floor Broker D will buy 3,000 contracts, and Floor Brokers C and D will sell to Floor Brokers E 470,000 shares of XYZ at $50.00/share, where 329,000 shares are sold by Floor Broker C and 141,000 shares are sold by Floor Broker D. Assume that the parties are on the floor of an options exchange and forward the terms of the stock leg order to an interdealer broker, who then forwards the order to a executing broker Participant for execution on the Exchange.

However, assume further that immediately after the parties relayed the terms of the original stock leg trade to the interdealer broker, Floor Broker D pulls out of the Stock-Option order because his customer cancels his order. Notwithstanding, Floor Brokers C and E wish to go forward with the transaction and agree to trade 7,000 contracts of XYZ Jan 50 call options at $4.50/share and hedge with a trade of 329,000 shares of XYZ at $50.00. Assume then that options leg executes at 7,000 contracts and before the adjusted terms to the stock leg quantity reaches the executing broker Participant, the stock leg executes at the original terms of 470,000 shares of XYX at $50.00 per share.

The Participant that submitted the stock leg trade (*i.e.,* the executing broker Participant) now wishes to adjust only the quantity of the stock leg trade to ensure that the hedge ratio remains the same as originally agreed. In addition to meeting the requirements of proposed paragraph (c)(1) and (c)(2), the Participant would have to submit the following documentation and calculations:

Pursuant to proposed subparagraph (B)(i), the Participant that submitted the stock leg trade would have to provide documentation that clearly shows the original hedge ratio agreed upon by all the parties to the Stock-Option order. In this case, the original hedge ratio was *0.47;*

Pursuant to proposed subparagraph (B)(ii), the Participant would have to provide an ESQ that maintains the original hedge ratio. Since the parties originally agreed to execute a delta-neutral hedge, the ESQ would be *329,000 shares* (*i.e.,* 7,000 contracts × 100 shares per contract = 700,000 shares

[45] Given that Floor Broker A is selling the underlying stock and Floor Broker B is buying the underlying stock, it stands to reason that Floor Broker A would prefer to round the CSP to a higher figure and Floor Broker B would prefer to round the CSP to a lower figure.

[46] Although proposed subparagraph (A)(iv) allows for the ASP to be within a permissible range, the actual determination of the ASP is not at random. As shown in Example 9, the ASP that is submitted to the Exchange is not a random number within the permissible range, but rather, the arithmetic mean of two legitimate, yet different values.

equivalent × 0.47 hedge ratio = ESQ of 329,000 shares); and

Pursuant to proposed paragraph (B)(iii), the Participant would have to submit an ASQ that is within the range 98.5% of the ESQ and 101.5% of the ESQ of 329,000. In this Example, the parties to the trade would likely agree that the CSQ should be the ASQ, since the adjustment to the quantity of a stock leg trade resulted in an exact Round Lot value.[47] Thus, the parties would likely agree to an ASQ of 329,000, which falls within the permissible range. Thus, the Exchange may accept the proposed quantity adjustment, so long as the other requirements of proposed Rule 11 are satisfied.

Proposed subparagraph (C) details the necessary calculations for Adjusted Stock Quantity for a Stock-Option order only, where an options leg trade executed at a price or was adjusted to a price other than the price originally agreed upon by all of the parties to the Stock-Option order and the parties wish to maintain the original delta-based hedge ratio. Thereunder, proposed subparagraphs (C)(i)–(iii) require the Participant that submitted the stock leg trade to submit:

(i) the delta used to calculate the size of the original stock leg trade (''Δ1'');

(ii) the proposed delta associated with the ASP (''Δ2'');

(iii) the proposed ESQ based on the following formula:

ESQ = (Original Stock Leg Quantity × Δ2)/Δ1

(iv) the proposed ASQ that comports with the following formula:

98.5% ESQ ≤ ASQ ≤ 101.5% ESQ

This adjustment calculation contemplates situations where a change in the delta value of the options leg would necessitate an adjustment to the quantity of the stock leg trade to maintain the delta-based hedge. If the original hedge ratio was delta-based, this calculation would permit an adjustment to the stock leg trade to maintain the original delta-based hedge ratio.[48] The following *Examples 11 and 12* illustrate how the requirements of proposed subparagraph (C) could be met.

Example 11. Assume the same as Example 8, except that the Participant that submitted the stock leg trade wished to adjust the *quantity* of the stock leg trade to maintain the original delta-neutral hedge, as opposed to adjusting the price of the stock leg trade to maintain the original aggregate cash flow. Assume that when the options leg executed at $4.40 per share, the corresponding delta value dropped from 0.47 to 0.45.[49] In order to adjust the quantity of the stock leg trade to comport with the correct delta to maintain a delta-neutral hedge, the Participant would have to submit the following information to the Exchange:

Pursuant to proposed subparagraph (C)(i), the Participant would have to provide documentation evincing the delta value of the options contract at $4.50/share was *0.47;*

Pursuant to proposed subparagraph (C)(ii), the Participant would have to provide documentation evincing the delta value of the options contract at $4.40/share to be approximately *0.45;*[50]

Pursuant to proposed subparagraph (C)(iii), the Participant would have to provide an ESQ that is the quotient of the product of the original stock leg quantity and the new delta and the original delta. In this case, the calculation would be (470,000 original shares × 0.45 new hedge ratio)/0.47 original hedge ratio = CSQ of 450,000 shares; and

Pursuant to proposed paragraph (C)(iv), the Participant would have to submit an ASQ that is within the range 98.5% of the CSQ and 101.5% of the ESQ, which in this Example would be 443,250 to 456,750. As noted above, the proposed adjusted delta is approximately 0.45.[51] It is possible that the parties may utilize slightly different delta values, depending on the reasonable option pricing model employed and the rounding methodology used.[52] If the respective delta values differ, then the CSQ would certainly be different. Thus, allowing the parties a *de minimis* range to reconcile such model and rounding inconsistencies would facilitate an agreement as to the ASQ. However, if the parties agree that the adjusted delta value should be exactly 0.45, then the CSQ would equal the ASQ at 450,000 shares.

Example 12. Assume the same as Example 8, except that parties to the Stock-Option trade wished to employ a *delta-based* hedge ratio where the stock leg trade represented 10% more stock than required for a delta-neutral hedge. Thus, the parties agreed that Floor Broker A would buy 10,000 XYZ Jan 50 calls from Floor Broker B for $4.50 per share and Floor Broker A would sell to Floor Broker B 517,000 shares of XYZ at $50.00/share, which is 10% more shares of XYZ than needed to effect a delta-neutral hedge where the delta value is 0.47. However, assume that market conditions in the options market resulted in the options leg executing at $4.40 per share with a corresponding delta value of 0.45. In order to adjust the quantity of the stock leg trade to maintain the original delta-based hedge ratio, the Participant that submitted the stock leg trade would have to submit the following information to the Exchange:

Pursuant to proposed subparagraph (C)(i), the Participant would have to provide documentation evincing the delta value of the options contract at $4.50/share was *0.47;*

Pursuant to proposed subparagraph (C)(ii), the Participant would have to provide documentation evincing the delta value of the options contract at $4.40/share to be approximately 0.45;

Pursuant to proposed subparagraph (C)(iii), the Participant would have to provide an ESQ that is the quotient of the product of the original stock leg quantity and the new delta and the original delta. In this case, the calculation would be (517,000 original shares × 0.45 new hedge ratio)/0.47 original hedge ratio = CSQ of 495,000 shares. As originally intended, 495,000 shares represents 10% more shares than required to create a delta-neutral hedge; and

Pursuant to proposed paragraph (C)(iv), the Participant would have to submit an ASQ that is within the range 98.5% of the CSQ and 101.5% of the ESQ, which in this Example would be 487,575 to 502,425. As discussed in Example 11, above, this *de minimis* range is necessary to address the possibility that the parties may utilize slightly different delta values, depending on the reasonable option pricing model employed and the rounding methodology used. However, if the parties agree that the adjusted

[47] If the ESQ were of a Mixed Lot quantity, the parties to the trade may wish to avoid a Mixed Lot stock trade, as such a trade can ultimately result in Odd Lot remainders. Thus, under those circumstances, the parties may agree to round the stock transaction down to the nearest Round Lot. It is important to note that the parties could not round up because that would result in the stock leg trade from not being adequately hedged by options contracts that represent at least the same number of shares as the stock leg, as required by the proposed definition of ''Stock-Option'' orders.

[48] The Exchange notes that it will only permit the parties to a Stock-Option trade to adjust either the quantity or price of the stock leg trade, pursuant to proposed paragraph (c)(3), based on the options leg executing at or being adjusted to a price other than the price originally agreed upon by all of the parties to the Stock-Option trade.

[49] Depending on how values are rounded, the delta of an option may be more than two digits.

[50] *Id.*

[51] *Id.*

[52] Unlike the ASP calculation where the original and adjusted prices are known based on the objective pricing information immediately discernible by the Exchange, when a price adjustment is made, the corresponding delta adjustment cannot be immediately discerned by the Exchange. Therefore, the Exchange submits that adopting a rule-based range of acceptable delta values is the most reasonable approach.

delta value should be exactly 0.45, then the CSQ would equal the ASQ at 495,000 shares.

Once the ASQ or ASP has been presented to the Exchange pursuant to proposed paragraph (c)(3), pursuant to proposed paragraph (c)(4), the Exchange would ascertain that the proposed adjusted stock leg trade could have been executed in the Matching System at the time the trade was initially executed, in compliance with all applicable CHX and SEC rules. The proposed paragraph further provides that, if the trade adjustment is approved, the adjustment shall be accepted, recorded, and submitted to a Qualified Clearly Agency, without regard to orders residing in the Matching System at the time the adjustment is made. Proposed paragraph (c)(4) mirrors proposed Rule 9(c), which deals with the validation of adjustments for trades based on Bona Fide Error.

Specifically, proposed paragraph (d)(4) is designed to reasonably ensure that a proposed adjusted trade would not have, *inter alia,* traded-through the CHX Book or a Protected Quotation of an external market in violation of Rule 611(a) of Regulation NMS. This validation illustrates the potential benefits of a stock leg trade adjustment, which is to preserve the timestamp of the original stock leg trade. Specifically, a trade adjustment would prevent the need to cancel the trade and resubmit a corrective trade and thereby prevent the possibility that the CHX Book would block the new stock leg trade from being executed, due to a better priced order, which was submitted after the trade cancellation, now resting on the CHX Book. Similarly, with respect to the NBBO, a trade adjustment would prevent the possibility that the NBBO would end up blocking the new stock leg trade from being executed.

Moreover, as discussed above, since many Stock-Option orders are submitted as QCTs, the timing of the execution of the different components is of paramount importance.[53] Therefore, the cancellation of a stock leg trade that is out-of-hedge and resubmission of a new corrective trade would rarely, if ever, meet QCT time requirement and would consequently require all components of the Stock-Option order to be cancelled and re-attempted. That is, a resubmitted stock leg trade could not be marked QCT, unless all of the components, including a good non-stock leg trade, were cancelled and re-executed. Therefore, trade adjustments have the added benefit of allowing market participants the ability to execute multi-component orders more efficiently.

Proposed paragraph (e) mirrors proposed Rule 9(d) and provides that if the Exchange approves a request for a stock leg trade cancellation or adjustment, any corrective action(s) necessary to effectuate the cancellation or adjustment, including, but not limited to, corrective entries into the Exchange's records and/or corrective clearing submissions to a Qualified Clearing Agency, shall be taken by Exchange operations personnel only. The purpose of this language is to clarify that the Participant's only role in the proposed trade adjustment or cancellation is to provide to the Exchange the required information and documentation as detailed under proposed Rule 11. Finally, proposed paragraph (f) mirrors proposed Rule 9(e) and provides that failure to comply with the provisions of this Rule shall be considered conduct inconsistent with just and equitable principles of trade and a violation of Article 9, Rule 2.

Implementation of Proposed Rules

Prior to implementing proposed Article 20, Rules 9, 9A, and 11, the Exchange will ensure that policies and procedures are in place to allow Exchange operations personnel to effectively monitor and surveil the use of the proposed cancellations, adjustments, and submission of ECTs. The Exchange notes that detailed policies and procedures are already in place and are being followed by Exchange operations personnel for all proposed Rules that merely clarify and detail existing functionality offered by the Exchange. To the extent that the proposed Rules allow for new functionality, existing policies and procedures will be expanded and refined to cover such new functionality.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act in general,[54] and furthers the objectives of Section 6(b)(5) in particular,[55] in that it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transaction in securities, to remove impediments and perfect the mechanisms of a free and open market, and, in general, to protect investors and the public interest.

Specifically, the proposed rules to permit the adjustment of Bona Fide Error trades furthers the objectives of the Act by allowing persons engaged in facilitating transactions in securities to remedy Bona Fide Errors without having to cancel the erroneous trade. This will, in turn, perfect the mechanisms of a free and open market by promoting efficient execution of trades and prevent the excessive reporting of activity to the Consolidated Tape.[56]

Moreover, the proposed rule change to expand situations where a Stock-Option or Stock-Future stock leg trade may be cancelled and to permit the adjustment of stock leg trades furthers the objectives of the Act by providing Participants the ability to better adapt to changes in the equities and derivatives markets. Specifically, the proposed rule change will allow Participants to adapt to changes to the options or futures leg and therefore facilitate the execution of Stock-Option or Stock-Future combination orders in ratios as originally agreed by the parties to the order.

In addition, the proposed rule change to permit the adjustment of the stock leg trade furthers the objectives of the Act by protecting investors and the public interest. From a cost standpoint, by allowing an adjustment to a stock leg trade, as opposed to outright cancellation and resubmission of a new order, Participants should realize cost-savings via reduced order cancellation fees.[57] The reduced fees will in turn protect investors by making the marketplace more accessible. Also, since the adjustment of a trade pursuant to the proposed rule changes eliminates the need for the parties to execute and report a replacement trade, the proposed rule should bolster the integrity and accuracy of the publicly disseminated trade reporting information, by removing duplicative trade reports. In addition, since the adjustment would only impact the parties to the options or futures transaction, the proposed amendments would not impact other Participants that submit orders on the Exchange. Finally, permitting the adjustment of the stock leg when the non-stock leg trade has been adjusted should reduce the credit risk to the parties involved in the transaction, by allowing such parties to adjust the stock leg to properly hedge the corresponding options or futures position and, therefore, prevent unwanted and/or unsustainable stock positions.

[53] *See supra* note 31.

[54] 15 U.S.C. 78f(b).

[55] 15 U.S.C. 78f(b)(5).

[56] *See supra* note 21.

[57] Section E.8 of the Exchange's Fee Schedule details a formula-based Order Cancellation Fee, which assess a daily cancellation fee per Account Symbol, if the order cancellation ratio exceeds a designated threshold.

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

The Exchange 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. The proposed changes will incentivize market participants to utilize the services offered by the Exchange by affording customers better opportunities to execute complex combination orders. By doing so, the Exchange is promoting competition among the trading centers, which will promote the public interest.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments were either solicited or received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove the proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/sro.shtml*); or
- Send an email to *rule-comments@sec.gov.* Please include File Number SR–CHX–2013–16 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–CHX–2013–16. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*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 Web site viewing and printing in the Commission's Public Reference Room 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 offices of CHX. 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–CHX–2013–16, and should be submitted on or before October 9, 2013.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[58]

Kevin M. O'Neill,

Deputy Secretary.

[FR Doc. 2013–22648 Filed 9–17–13; 8:45 am]

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[58] 17 CFR 200.30–3(a)(12).

SMALL BUSINESS ADMINISTRATION

[License No. 07/07–0116]

Eagle Fund III, L.P.; Notice Seeking Exemption Under the Small Business Investment Act, Conflicts of Interest

Notice is hereby given that Eagle Fund III, L.P., 101 S. Hanley Road, Suite 1250, St. Louis, Missouri 63105, a Federal Licensee under the Small Business Investment Act of 1958, as amended (the "Act"), in connection with the financing of a small concern, has sought an exemption under Section 312 of the Act and 13 CFR 107.730, Financings which Constitute Conflicts of Interest, of the Small Business Administration ("SBA") Rules and Regulations. Eagle Fund III, L.P., provided debt and equity financing to Net Direct Merchants LLC ("Net Direct"), 217 North Seminary Street, Florence, AL, 35630. The financing was contemplated to provide capital that contributes to the growth and overall sound financing of Net Direct.

The financing is brought within the purview of § 107.730(a)(1) because Eagle Fund II, L.P., an Associate of Eagle Fund III, L.P. as defined in § 107.50, owns a ten percent or greater equity interest in Net Direct. Accordingly, Net Direct is considered an Associate of Eagle Fund III, L.P.

Notice is hereby given that any interested person may submit written comments on the transaction to the Acting Associate Administrator for Investment and Innovation, U.S. Small Business Administration, 409 Third Street SW., Washington, DC 20416.

Pravina Raghavan,

Acting Associate Administrator for Investment and Innovation.

[FR Doc. 2013–22415 Filed 9–17–13; 8:45 am]

BILLING CODE P

SMALL BUSINESS ADMINISTRATION

[License No. 07/07–0117]

Eagle Fund III–A, L.P.; Notice Seeking Exemption Under the Small Business Investment Act, Conflicts of Interest

Notice is hereby given that Eagle Fund III–A, L.P., 101 S. Hanley Road, Suite 1250, St. Louis, Missouri 63105, a Federal Licensee under the Small Business Investment Act of 1958, as amended (the "Act"), in connection with the financing of a small concern, has sought an exemption under Section 312 of the Act and 13 CFR 107.730, Financings which Constitute Conflicts of Interest, of the Small Business Administration ("SBA") Rules and Regulations. Eagle Fund III–A, L.P., provided debt and equity financing to Net Direct Merchants LLC, ("Net Direct"), 217 North Seminary Street, Florence, AL 35630. The financing was contemplated to provide capital that contributes to the growth and overall sound financing of Net Direct.

The financing is brought within the purview of § 107.730(a)(1) because Eagle Fund II, L.P., an Associate of Eagle Fund III–A, L.P. as defined in § 107.50, owns a ten percent or greater equity interest in Net Direct. Accordingly, Net Direct is considered an Associate of Eagle Fund III–A, L.P.

Notice is hereby given that any interested person may submit written comments on the transaction to the Acting Associate Administrator for Investment and Innovation, U.S. Small