

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-75245; File No. SR-CBOE-2015-026]

### Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change Relating to Rules 6.74A and 6.74B

June 18, 2015.

#### I. Introduction

On March 6, 2015, Chicago Board Options Exchange, Incorporated (the “Exchange” or “CBOE”) filed with the Securities and Exchange Commission (the “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend its rules regarding the solicitation of Market-Makers as the contra party to an agency order entered into the Exchange’s Automated Improvement Mechanism (“AIM”) and Solicitation Auction Mechanism (“SAM”) auctions. The proposed rule change was published for comment in the **Federal Register** on March 23, 2015.<sup>3</sup> On May 4, 2015, the Commission extended the time period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change, to June 21, 2015.<sup>4</sup> The Commission received no comment letters on the proposed rule change. This order institutes proceedings under section 19(b)(2)(B) of the Act<sup>5</sup> to determine whether to approve or disapprove the proposed rule change.

#### II. Description of the Proposal

A CBOE Trading Permit Holder (“Initiating TPH”) may electronically execute an order it represents as agent (“Agency Order”) against principal interest or against a solicited order, by submitting the Agency Order for electronic execution into the AIM pursuant to CBOE Rule 6.74A. Also, an Initiating TPH may electronically execute certain Agency Orders against solicited orders, by submitting the Agency Order for electronic execution into the SAM pursuant to CBOE Rule 6.74B. CBOE rules currently require that

any solicited orders submitted by an Initiating TPH into the AIM<sup>6</sup> or SAM<sup>7</sup> (together, the “Auctions”) to trade against an Agency Order may not be for the account of a Market-Maker assigned to the option class.<sup>8</sup> The Exchange proposes to eliminate from its rules the restriction against soliciting Market-Makers assigned to an options class as the contra party in the Auctions.

According to the Exchange, the current rules act to limit an Initiating TPH from access to liquidity that the Exchange believes should otherwise be available.<sup>9</sup> Because a TPH initiating an AIM or SAM auction in an option class cannot solicit contra orders from Market-Makers assigned to the option class, the Exchange proposes to delete the rule language imposing this prohibition, which it believes will allow the TPH to access the additional liquidity that these market making firms can provide.<sup>10</sup> The Exchange believes the proposed rule change is a reasonable modification designed to provide additional flexibility for the Exchange’s TPHs to obtain executions on behalf of their customers and to provide CBOE Market-Makers assigned to a given option class with the same opportunity as other solicited parties to participate in the auction process through means of solicited orders submitted by the Initiating TPH.<sup>11</sup> Additionally, the Exchange does not believe the proposed rule change will deplete the liquidity available through Auctions. Instead, the Exchange believes that by allowing more individuals to participate in the

Auction process (*i.e.*, through solicitation), liquidity will increase.<sup>12</sup>

The Exchange further notes that a Market-Maker that is solicited to trade against an Agency Order in a class in which the Market-Maker is appointed would be required to abide by Exchange Rules 4.1 (Just and Equitable Principles of Trade), 4.18 (Prevention of the Misuse of Material, Nonpublic Information), and 6.9 (Solicited Transactions) (as well as all other Exchange rules). The Exchange states that a Market-Maker would still be prohibited from, for example, learning (via solicitation) that a large order is being sent to the Exchange and therefore widening its quotes. Moreover, the Exchange argues that because upon entry an Auction order is “stopped” for its full quantity at the contra order’s price, the price of the trade would not be impacted if a Market-Maker were to widen its quotes. The Exchange also believes that because many classes on the Exchange have a number of Market-Makers appointed, the widening of quotes by one Market-Maker would likely have limited impact on the NBBO.<sup>13</sup> Additionally, the Exchange does not believe that the proposed rule change would have an adverse effect on quoting because in order to execute against order flow outside of the Auctions or on other exchanges, Market Makers will have to continue to quote aggressively.<sup>14</sup>

The proposed rule change also would provide that “a Market-Maker submitting a solicited order to execute against a particular Agency Order may not modify its pre-programmed response to Request for Responses based on information regarding the particular Agency Order or solicited order.”<sup>15</sup> The Exchange believes that this rule language would prohibit a Market-Maker from using any information regarding a particular Agency Order or the Market-Maker’s solicited order for purposes of modifying the Market-Maker’s response to an Auction Request for Responses.<sup>16</sup>

<sup>6</sup> See CBOE Rule 6.74A.

<sup>7</sup> See CBOE Rule 6.74B. The Exchange notes that the SAM Auction is currently deactivated. See *CBOE Regulatory Circular RG14-076—Deactivation of the Solicitation Auction Mechanism (SAM)* (May 16, 2014).

<sup>8</sup> See Interpretation and Policy .04 to CBOE Rule 6.74A and Interpretation and Policy .03 to CBOE Rule 6.74B.

<sup>9</sup> The Exchange argues that the current rules effectively prohibit small market making firms from providing liquidity in the form of contra orders, whereas the current rules neither prohibit the proprietary arm of a global firm from submitting a contra order in these Auctions nor prohibit a global firm’s market making operation from responding to an Auction in which the proprietary desk has submitted a contra order. Additionally, CBOE states that if two Market-Makers are nominees of the same firm—one appointed to a class on CBOE and the other appointed in the same class on another exchange (PHLX for example)—the current rules allow the PHLX Market-Maker to be solicited to participate on an AIM order and the CBOE Market-Maker to respond to the AIM auction. See Notice, *supra* note 3, at 15265.

<sup>10</sup> See *id.*

<sup>11</sup> If CBOE Market-Makers assigned to a given option class cannot be solicited, they will not be able to obtain the favorable priority status when trading against Agency Orders executed through the Auctions, while all other parties solicited by the Initiating TPH may have such priority status.

<sup>12</sup> See Notice, *supra* note 3, at 15265.

<sup>13</sup> See *id.*

<sup>14</sup> See *id.*

<sup>15</sup> See *id.* at 15266.

<sup>16</sup> However, the Exchange states that a Market-Maker’s quotes may change for many reasons other than an Agency Order or the Market-Maker’s solicited order (*e.g.*, a non-exclusive list of reasons that a Market-Maker may choose to adjust the size and/or price of quotes, irrespective of an Agency Order or a Market-Maker’s solicited order, is a change in the price of the underlying, the Market-Maker’s inventory, or interest rates), and according to the Exchange those unrelated changes would not be prohibited under the proposed rule change. The Exchange also notes that this language is not intended to prohibit a Market-Maker from providing

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 74519 (March 17, 2015), 80 FR 15264 (“Notice”).

<sup>4</sup> See Securities Exchange Act Release No. 74862 (May 4, 2015), 80 FR 26599 (May 8, 2015).

<sup>5</sup> 15 U.S.C. 78s(b)(2)(B).

### III. Proceedings to Determine Whether to Approve or Disapprove SR-CBOE-2015-026 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to section 19(b)(2)(B) of the Act<sup>17</sup> to determine whether the proposed rule change should be approved or disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change, as discussed below. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as described in greater detail below, the Commission seeks and encourages interested persons to provide additional comment on the proposed rule change.

As discussed above, the Exchange proposes to amend CBOE Rules 6.74A and 6.74B, in order to permit a Market-Maker assigned to an option class to be solicited as the contra party to an Agency Order in that class on the Exchange's Auctions. The Commission believes that the proposal raises important issues that warrant further public comment and Commission consideration. Specifically, the Commission believes that proceedings are appropriate to consider, among other matters, the impact of the proposal on competition in the Auctions, incentives for Market-Makers to continue to quote aggressively, and CBOE's ability to deter potential abuses involving the non-public information obtained through the solicitation process.

The prohibition on the solicitation of Market-Makers assigned to an option class as the contra party to an Agency Order in the Auctions has been in place on CBOE since the AIM was adopted in 2006<sup>18</sup> and the SAM was adopted in 2008.<sup>19</sup> In addition, the Commission has noted that the same prohibition, contained in the rules of another SRO, was designed to permit the price improvement auction and solicitation mechanism to remain mechanisms for exposing solicited transactions to the competition of the marketplace.<sup>20</sup> Because the current proposal would

remove this prohibition, it raises questions as to whether the proposal may undermine the quality of competition in the Auctions. For example, the Commission notes that responses to an AIM Request for Responses ("RFR") broadcast may only be submitted by Market-Makers with an appointment in the relevant option class and TPH's acting as agent for orders resting at the top of the Exchange's book opposite the Agency Order.<sup>21</sup> The proposed rule change thus raises concerns that the quality of the Auctions may degrade to the extent the number of potential responders is reduced because one of the responders is now the solicited party. Although the Exchange argues that its proposal will lead to increased liquidity in the Auctions,<sup>22</sup> the Exchange has not provided any data to support its arguments.

Additionally, because solicited Market-Makers may receive material non-public information regarding an Agency Order as part of the solicitation process, the proposed rule change raises concerns that Market-Makers may alter their quoting behavior by, for example, widening their quotes when learning (*i.e.*, through solicitation) that a large order is being sent to the Exchange. In the CBOE AIM Approval Order, the Commission noted that the prohibition against soliciting Market-Makers in the class to be the contra party to the Agency Order, as well as CBOE Rules limiting solicitation from members or nonmember customers or broker-dealers<sup>23</sup> and prohibiting members from engaging in acts or practices inconsistent with just and equitable principles of trade,<sup>24</sup> "should permit members to solicit, in advance, the other side of an order, while providing for adequate disclosure of such orders to limit manipulation and abuse."<sup>25</sup> The Commission believes that proceedings are appropriate to consider whether the proposed rule that would prohibit a solicited Market-Maker from modifying its pre-programmed response to an RFR based on information regarding the particular Agency Order or solicited order is sufficient, in conjunction with other Exchange rules, to address concerns about the potential misuse of non-public information obtained through the solicitation process.

Pursuant to section 19(b)(2)(B) of the Act,<sup>26</sup> the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of, and input from commenters with respect to, the proposed rule change's consistency with section 6(b)(5) of the Act,<sup>27</sup> which requires that the rules of a national securities exchange be designed, among other things, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest. The Commission is also instituting proceedings to allow for additional analysis of, and input from commenters with respect to, the proposed rule change's consistency with section 6(b)(8) of the Act,<sup>28</sup> which requires that the rules of a national securities exchange do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

### IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data and arguments with respect to the concerns identified above, as well as any other concerns they may have with the proposed rule change. In particular, the Commission invites the written views of interested persons concerning whether the proposal is inconsistent with sections 6(b)(5)<sup>29</sup> and 6(b)(8)<sup>30</sup> or any other provision of the Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval which would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4 under the Act,<sup>31</sup> any request for an

multiple responses to a Request for Responses. *See id.*

<sup>17</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>18</sup> *See* Securities Exchange Act Release No. 53222 (February 3, 2006), 71 FR 7089 (February 10, 2006) (SR-CBOE-2005-60) ("CBOE AIM Approval Order").

<sup>19</sup> *See* Securities Exchange Act Release No. 57610 (April 3, 2008), 73 FR 19535 (April 10, 2008) (SR-CBOE-2008-14).

<sup>20</sup> *See* Securities Exchange Act Release No. 54644 (October 23, 2006), 71 FR 63374, 63375 (October 30, 2006) (SR-ISE-2004-17).

<sup>21</sup> *See* CBOE Rule 6.74A(b)(1)(D)-(E).

<sup>22</sup> *See* Notice, *supra* note 3, at 15265.

<sup>23</sup> *See* CBOE Rule 6.9.

<sup>24</sup> *See* CBOE Rule 4.1.

<sup>25</sup> *See* CBOE AIM Approval Order, *supra* note 21, at 7091.

<sup>26</sup> 15 U.S.C. 78s(b)(2)(B). Section 19(b)(2)(B) of the Exchange Act also provides that proceedings to determine whether to disapprove a proposed rule change must be concluded within 180 days of the date of publication of notice of the filing of the proposed rule change. *See id.* The time for conclusion of the proceedings may be extended for up to 60 days if the Commission finds good cause for such extension and publishes its reasons for so finding. *See id.*

<sup>27</sup> 15 U.S.C. 78f(b)(5).

<sup>28</sup> 15 U.S.C. 78f(b)(8).

<sup>29</sup> 15 U.S.C. 78f(b)(5).

<sup>30</sup> 15 U.S.C. 78f(b)(8).

<sup>31</sup> 17 CFR 240.19b-4.

opportunity to make an oral presentation.<sup>32</sup>

Interested persons are invited to submit written data, views, and arguments regarding whether the proposal should be approved or disapproved by July 15, 2015. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by July 29, 2015. In light of the concerns raised by the proposed rule change, as discussed above, the Commission invites additional comment on the proposed rule change as the Commission continues its analysis of the proposed rule change's consistency with sections 6(b)(5) and 6(b)(8),<sup>33</sup> or any other provision of the Act, or the rules and regulations thereunder. The Commission asks that commenters address the sufficiency and merit of the Exchange's statements in support of the proposed rule change, in addition to any other comments they may wish to submit about the proposed rule change. In particular, the Commission invites comment on the following:

1. What are commenters' views on how CBOE's proposal could impact the quality of the Auctions, internalization rates, liquidity, and competition, within or outside of the Auctions?

2. What are commenters' views on the potential impact of CBOE's proposal on the quoting behavior of Market-Makers?

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](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2015-026 on the subject line.

#### *Paper Comments*

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-CBOE-2015-026. 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

<sup>32</sup> Section 19(b)(2) of the Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants to the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

<sup>33</sup> 15 U.S.C. 78f(b)(5), (b)(8).

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-CBOE-2015-026 and should be submitted by July 15, 2015. Rebuttal comments should be submitted by July 29, 2015.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>34</sup>

**Brent J. Fields,**

*Secretary.*

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## **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-75246; File No. SR-FINRA-2015-018]

### **Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to the Series 4 Examination Program**

June 18, 2015.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" or "SEA")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 12, 2015, Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. FINRA

<sup>34</sup> 17 CFR 200.30-3(a)(57).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

has designated the proposed rule change as "constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule" under Section 19(b)(3)(A)(i) of the Act<sup>3</sup> and Rule 19b-4(f)(1) thereunder,<sup>4</sup> which renders the proposal effective upon receipt of this filing by the Commission. 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**

FINRA is filing revisions to the content outline and selection specifications for the Registered Options Principal (Series 4) examination program.<sup>5</sup> The proposed revisions update the material to reflect changes to the laws, rules and regulations covered by the examination and to incorporate the functions and associated tasks currently performed by a Registered Options Principal. In addition, FINRA is proposing to make changes to the format of the content outline. FINRA is not proposing any textual changes to the By-Laws, Schedules to the By-Laws or Rules of FINRA.

The revised content outline is attached.<sup>6</sup> The Series 4 selection specifications have been submitted to the Commission under separate cover with a request for confidential treatment pursuant to SEA Rule 24b-2.<sup>7</sup>

The text of the proposed rule change is available on FINRA's Web site at <http://www.finra.org>, at the principal office of FINRA and at the Commission's Public Reference Room.

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

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A)(i).

<sup>4</sup> 17 CFR 240.19b-4(f)(1).

<sup>5</sup> FINRA also is proposing corresponding revisions to the Series 4 question bank. Based on instruction from SEC staff, FINRA is submitting this filing for immediate effectiveness pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(1) thereunder, and is not filing the question bank for review. See Letter to Alden S. Adkins, Senior Vice President and General Counsel, NASD Regulation, from Belinda Blaine, Associate Director, Division of Market Regulation, SEC, dated July 24, 2000. The question bank is available for SEC review.

<sup>6</sup> The Commission notes that the revised content outline is attached to the filing, not to this Notice. The content outline is available as part of the filing on FINRA's Web site.

<sup>7</sup> 17 CFR 240.24b-2.