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SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68964; File No. SR-C2-2013-008)

February 21, 2013

Self-Regulatory Organizations; C2 Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change, as Modified by Amendment No. 1 Thereto, Relating to Market-Maker Continuous Quoting Obligations

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on February 8, 2013, C2 Options Exchange, Incorporated (the “Exchange” or “C2”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On February 20, 2013, the Exchange submitted Amendment No. 1 to the proposed rule change. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to amend its Rules relating to Market-Maker continuous quoting obligations. The text of the proposed rule change is available on the Exchange’s website (<http://www.c2exchange.com/Legal/>), at the Exchange’s Office of the Secretary, and at the Commission.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The purpose of the proposed rule change is to add language to Exchange Rules 8.5 and 8.17 to exclude intra-day add-on series ("Intra-day Adds") on the day during which such series are added for trading from Market-Makers'³ quoting obligations. Additionally, the proposed rule change clarifies in Rule 8.19 that Designated Primary Market-Makers ("DPMs), respectively (Market-Makers and DPMs are collectively referred to in this filing as "Market-Makers" unless the context provides otherwise) may still receive participation entitlements pursuant to those Rules in all Intra-day Adds on the day during which such series are added for trading in which they are quoting provided that Market-Maker meets all other entitlement requirements as set forth in the applicable rule.

Intra-Adds are series that are be added to the Exchange system after the opening of the Exchange. These series may be added throughout the trading day which differs from other newly added series which are only added prior to the beginning of trading. In the event a series is added after the open of trading on the Exchange, the Exchange, in real time, disseminates a message to the Exchange application program interfaces, which any Exchange Trading Permit Holder ("TPH") can receive, that a new series has been listed. In addition, there is a corresponding product state change message disseminated when the new series moves from pre-

³ See Exchange Rule 8.1 which defined Market-Makers as participants that "have certain rights and bear certain responsibilities beyond those of other Participants."

opening rotation to an open state. Any Market-Maker with an appointment in the class in which the series was added is permitted to quote in the new series.

Currently, Exchange Rules 8.5 and 8.17 impose certain obligations on Market-Makers and DPMs, respectively, including obligations to provide continuous quotes as follows⁴:

- Rule 8.5 requires that Market-Makers provide a continuous two-sided market in 60% of the non-adjusted option series of the Market-Maker's appointed class that have a time to expiration of less than nine months;
- Rule 8.17(a)(1) requires DPMs to provide continuous quotes in at least the lesser of 99% or 100% minus one call-put pair⁵ of the non-adjusted option series of each class allocated to it.

Exchange Rule 8.19 provides that DPMs generally will receive the participation entitlements in their assigned classes when quoting at the best price if they satisfy their obligations and other conditions set forth in the rules. Specifically, Rule 8.19 provides that the DPM participation entitlement will be 50% when there is one Market-Maker also quoting at the best price on the Exchange and 40% when there are two Market-Makers also quoting at the best price on the Exchange.⁶

⁴ For purposes of Rules 8.5(a)(1), and 8.17(a)(1), "continuous" means 90% of the time. If a technical failure of limitation of the System prevents a Market-Maker from maintaining timely and accurate quotes in a series, the duration of such failure will not be included in the 90% determination.

⁵ See Rule 8.17(a)(1) which defines a "call-up pair" as "one call and one put that cover the same underlying instrument and have the same expiration date and exercise price."

⁶ The participation entitlements of DPMs are based on the number of contracts remaining after all public customer orders in the book at the best price on the Exchange have been satisfied. Additionally, a DPM may not be allocated a total quantity greater than the quantity for which the DPM is quoting at the best price. See Rules 8.19(b)(1)(B) and (C).

In order to comply with their continuous quoting obligations, Exchange Market-Makers have automated systems in place that use complex calculations based on a variety of market factors to compute quotes in their appointed classes and transmit these quotes to the Exchange's System (the "System").⁷ Their system computations also factor in their market risk models. Several Market-Makers have communicated to the Exchange that their trading systems do not automatically produce continuous quotes in Intra-day Adds on the trading day during which those series are added. They further indicated that the only way they could quote in these series on the trading day during which they were added would be to completely shut down and restart their systems. As a result, it is the Exchange's understanding that several Market-Makers do not currently quote Intra-day Adds during the trading day on which such series are added (although the Market-Makers generally do quote these series upon the opening of the next trading day, assuming those series are still listed on the Exchange). The required work on Market-Makers' systems to quote Intra-day Adds, as further communicated to the Exchange, would be significant and costly.

Intra-day Adds make it extremely difficult for Market-Makers to comply with their obligation to quote in a substantial percentage of series in their appointed classes during a trading day on which Intra-day Adds are added in those classes. For example, if there are 1,000 series listed in a DPM's appointed class and the DPM is quoting in 990 of these series, the DPM is in compliance with the current minimum requirement to quote in 99% of series in its appointed class (assuming the DPM quotes in this number of series 90% of the trading day). However, if an Intra-day Add is added in the DPM's appointed class during the trading day, and the DPM's system does not automatically quote in this series, then the DPM would not comply, as it would

⁷ See Rule 1.1 which defines "System" as the "automated trading system used by the Exchange for the trading of options contracts."

be quoting in 990 of 1,001 series. This noncompliance would be compounded if more than one Intra-day Add is listed in a class during the same trading day. Further, if these Market-Makers turned their systems off to quote in Intra-day Adds on the trading day during which those series are added, then the Market-Makers could satisfy the standard to quote in a minimum percentage of series in their appointed classes but would then risk violating their obligation to quote for minimum percentage of the trading day as, theoretically, these Market-Makers might need to repeatedly turn their systems off to accommodate the Intra-day Adds.

The Exchange believes that it would be impracticable, particularly given that a number of Market-Makers use their systems to quote on multiple markets and not solely on the Exchange, for Market-Makers to turn off their entire systems to accommodate quoting in Intra-day Adds on the day during which those series are added on the Exchange. In addition, the Exchange believes this would interfere with the continuity of its market and reduce liquidity, which would ultimately harm investors and contradicts the purpose of the Market-Maker continuous quoting obligation.

This proposed rule change excludes Intra-day Adds from these continuous quoting obligations to address this conflict. Specifically, the Exchange is proposing to add text to Rules 8.5 and 8.17 to exclude Intra-day Adds on the day during which such series are added for trading from Market-Makers' quoting obligations. Based on communications from Market-Makers, the Exchange is concerned that Market-Makers may withdraw from the DPM program and that other market participants may be discouraged from requesting Market-Maker appointments or applying to the DPM program if they are required to quote Intra-day Adds on the trading day during which those series are added. The Exchange believes that withdrawals from, and reduced applications for, Market-Maker appointments would negatively impact liquidity and volume on

the Exchange in those classes. The Exchange believes that providing Market-Makers with relief from their quoting obligations with respect to Intra-day Adds on the trading day during which they are added for trading will prevent these withdrawals and encourage market participants to apply for or continue their Market-Maker class appointments.

The Exchange does not believe this relief will result in any material decrease in liquidity. As mentioned above, it is the Exchange's understanding that several Market-Makers currently do not quote Intra-day Adds on the trading day during which they are added, so the Exchange believes this proposed relief would result in a minimal reduction, if any, in liquidity in these series. These Market-Makers' systems would add these series the next trading day, so if there is any slight reduction in liquidity in these few series, it would only last for a short period of time (until the following trading day). Additionally, this potential small reduction in liquidity would be far outweighed by the reduction in liquidity that the Exchange believes would result from the withdrawals from and reductions in applications for Market-Maker appointments if the Exchange did not provide this relief.

The current quoting obligation in Intra-day Adds is a minor part of a Market-Maker's overall obligations. Specifically, Intra-day Adds represent only approximately 0.10% of the number of series listed on the Exchange, so Market-Makers will still be obligated to provide continuous two-sided markets in a substantial number of series in their appointed classes.⁸ Intra-day Adds are rarely added on the Exchange, so Market-Makers will still be obligated to provide continuous two-sided markets in a substantial number of series in their appointed classes. Further, Market-Makers would still be obligated to quote the Intra-day Adds the following day,

⁸ From January 1, 2013 through February 19, 2013, there have been 37 Intra-day Adds listed on the Exchange, and, in that time period, there have been a total of 35,502 series added on the Exchange. Thus, the Intra-day Adds represent 0.10%.

and, thus, their quoting relief is very short-lived and could, potentially, only last a few hours or until the opening of trading the following day. The Exchange believes that the burden of continuous quoting in this extremely small number of series is counter to the Exchange's efforts to continuously increase liquidity in its listed option classes.

The Exchange believes the proposed rule change will continue to ensure that Market-Makers create a fair and orderly market in the option classes to which they are assigned, as it does not absolve Market-Makers from providing continuous quotes in a significant percentage of series of each class for a substantial portion of the trading day. Market-Makers must engage in activities that constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market, including (1) competing with other Market-Makers to improve markets in all series of options classes comprising their appointments, (2) making markets that, absent changed market conditions, will be honored in accordance with firm quote rules, and (3) updating market quotations in response to changed market condition in their appointed options classes and to assure that any market quote it causes to be disseminated is accurate.⁹

The relief proposed in this filing is mitigated by a Market-Maker's other obligations. For example, the proposed rule change would not excuse a Market-Maker from its obligation to submit a single quote or maintain continuous quotes in one or more series of a class to which the Maker-Maker is appointed when called upon by an Exchange official if, in the judgment of such official, it is necessary to do so in the interest of maintaining a fair and orderly market.¹⁰

The proposed rule change also clarifies in the Exchange Rules that while Market-Makers are not required to provide continuous quotes in Intra-day Adds on the day during which such

⁹ See Rule 8.5(a).

¹⁰ See Rule 8.5(d).

series are added for trading, a Market-Maker may still receive a participation entitlement in such series if it elects to quote in that series and otherwise satisfies the other entitlement requirements set forth in accordance with the Rules. Specifically, the Exchange is proposing to add language to Rule 8.19 clearly stating that DPMs may still receive participation entitlements pursuant to those Rules in all Intra-day Adds on the day during which such series are added for trading in which they are quoting provided that Market-Maker meets all other entitlement requirements as set forth in Rule 8.19(b).

Market-Makers already receive participation entitlements in series they are not required to quote. For example, a DPM is currently required to provide continuous quotes in at least 99% of the non-adjusted option series or 100% of the non-adjusted series minus one call-put pair of each option class allocated to it for 90% of the trading day.¹¹ If the DPM elects to quote in 100% of the non-adjusted series in an option class allocated to it, it will receive a participation entitlement in all of those series when quoting at the best price, including the 1% of the series in which it is not required to quote in. Thus, under the proposed rule change, the market would continue to function as it does now. The Exchange believes this benefit is appropriate, as it incentivizes Market-Makers to quote in as many series as possible in their appointed classes, even those series in which the Rules do not require them to continuously quote.

The Exchange does not believe that the proposed rule change would adversely affect the quality of the Exchange's markets or lead to a material decrease in liquidity. Rather, the Exchange believes that its current market structure, with its high rate of participation by Market-Makers, permits the proposed rule change without fear of losing liquidity. The Exchange also believes that market-making activity and liquidity could materially decrease without the

¹¹ See Rule 8.17(a).

proposed rule change to exclude Intra-day Adds from Market-Maker continuous quoting obligations on the trading day during which they are added for trading. The Exchange believes that this proposed relief will encourage Market-Makers to continue appointments and other TPHs to request Market-Maker appointments, and, as a result, expand liquidity in options classes listed on the Exchange to the benefit of the Exchange and its TPHs and public customers. The Exchange believes that its Market-Makers would be disadvantaged without this proposed relief, and other TPHs and public customers would also be disadvantaged if Market-Makers withdrew from appointments in options classes, resulting in reduced liquidity and volume in these classes. Additionally, the Exchange believes that the proposed rule change to clarify that Market-Makers may receive participation entitlements in Intraday Adds on the day during which such series are added for trading if it satisfies the other entitlement requirements as set forth in Exchange Rules, even if the Rules do not require the Market-Makers to continuously quote in those series, will incent Market-Makers to quote in series in which they are not required to quote, which may increase liquidity in their appointed classes.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Securities Exchange Act of 1934 (the “Act”) and the rules and regulations thereunder applicable to the Exchange and, in particular, the requirements of Section 6(b) of the Act.¹² Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)¹³ requirements that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with

¹² 15 U.S.C. 78f(b).

¹³ 15 U.S.C. 78f(b)(5).

respect to, and facilitation transactions in securities, 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. Additionally, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)¹⁴ requirement that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

In particular, the Exchange believes the proposed rule change to exclude Intra-day Adds during the day which such series are added for trading from Market-Makers' quoting obligations promotes just and equitable principles of trade because it promotes liquidity and continuity in the marketplace and would prevent interruptions in quoting or reduced liquidity that may otherwise result. The Exchange also believes that the proposed rule change supports the quality of the Exchange's markets because it does not significantly change the current quoting obligations of Market-Makers. Market-Makers must still provide continuous quotes for a significant part of the trading day in a substantial number of series of each appointed class. Even if a Market-Maker does not quote Intra-day Adds on the trading day during which they are added, this would be offset by the Market-Maker's continued other obligations. The proposed relief is further offset by a Market-Maker's obligation to quote in these series beginning the next trading day.

Accordingly, the proposed rule change supports the quality of the Exchange's trading markets by helping to ensure that Market-Makers will continue to be obligated to quote in Intra-day Adds if, and when, the need arises and on an ongoing basis following the trading day during which the series are added. The Exchange believes this proposed change is reasonable and is offset by Market-Makers' continued responsibilities to provide significant liquidity to the market to the benefit of market participants.

¹⁴

Id.

The Exchange believes this proposed rule change, on balance, is a minor change and should not impact the quality of the Exchange's trading markets. Among other things, Intra-day Adds represent an insignificant percentage of series listed on the Exchange each day. The Exchange further believes that the potential small reduction in liquidity in Intra-day Adds that may result from the proposed relief would be far outweighed by the significant reduction in liquidity in appointed classes that the Exchange believes could occur from withdrawals from and reductions in applications for Market-Maker appointments without the proposed relief. The proposed rule change also removes impediments to and allows for a free and open market, while protecting investors, by promoting additional transparency regarding Market-Makers' obligations and benefits in the Exchange Rules. In addition, the Exchange believes that the proposed rule change is designed to not permit unfair discrimination among Market-Makers, as the proposed rule change provides the proposed relief for all Market-Makers.

The proposed rule change to clarify that Market-Makers may receive participation entitlements in Intra-day Adds in their appointed classes in which they are quoting, even though they are not required to quote, if the other requirements set forth in the Rules are satisfied, further supports the quality of the Exchange's trading markets because it encourages Market-Makers to quote in as many series as possible, which ultimately benefits all investors. This benefit is offset by the Market-Makers' continued quoting obligations and the fact that their quotes in these "non-required" series must still satisfy all of the Market-Makers' other obligations under the Rules. The Exchange also believes that this proposed change is consistent with its current practice, pursuant to which Market-Makers receive participation entitlements in additional series in which they elect to quote above the minimum percentage of series in which they are required to continuously quote under the Rules.

For the foregoing reasons, the Exchange believes that the proposed rule change is appropriate and consistent with the Act.

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

C2 does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange does not believe the proposed rule change to exclude Intra-day Adds during the day which such series are added for trading from Market-Makers' quoting obligations will cause any unnecessary burden on intramarket competition because it provides the same relief to a group of similarly situated market participants – Market-Makers. The Exchange does not believe the proposed change will cause any unnecessary burden on intermarket competition because Intra-day Adds are a very small portion of series on the Exchange. Exchange further believes that the potential small reduction in liquidity in Intra-day Adds that may result from the proposed relief would be far outweighed by the significant reduction in liquidity in appointed classes that the Exchange believes could occur from withdrawals from and reductions in applications for Market-Maker appointments without the proposed relief. In addition, the Exchange believes that the proposed rule change will in fact relieve any burden on, or otherwise promote, competition. The Exchange believes that excluding Intra-day Adds on the day during which they are added for trading from Market-Maker obligations will promote trading activity on the Exchange to the benefit of the Exchange, its TPHs, and market participants.

The Exchange does not believe the proposed rule change to clarify that Market-Makers may receive participation entitlements in Intra-day Adds in their appointed classes in which they are quoting, even though they are not required to quote, if the other requirements set forth in the Rules are satisfied, will cause any unnecessary burden on intramarket competition because it too provides the same relief to a group of similarly situated market participants – Market-Makers.

The Exchange does not believe the proposed change will cause any unnecessary burden on intermarket competition because Market-Makers are currently entitled to receive participation entitlements on series they are not obligated to quote in under the Rules. In addition, the Exchange believes that the proposed rule change will in fact relieve any burden on, or otherwise promote, competition. The Exchange believes allowing Market-Makers to receive a participation entitlements in Intra-day Adds will promote trading activity on the Exchange because it will incentivize Market-Makers to quote in such series though not obligated to do so to the benefit of the Exchange, its TPHs, and market participants.

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

The Exchange neither solicited nor received comments on the proposed rule change.

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

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

- A. by order approve or disapprove such 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 e-mail to rule-comments@sec.gov. Please include File Number SR-C2-2013-008 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-C2-2013-008. This file number should be included on the subject line if e-mail 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 website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. 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-C2-2013-008, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁵

Kevin M. O'Neill
Deputy Secretary

[FR Doc. 2013-04544 Filed 02/26/2013 at 8:45 am; Publication Date: 02/27/2013]

¹⁵ 17 CFR 200.30-3(a)(12).