



8011-01
SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-79589; File No. SR-CBOE-2016-086)

December 19, 2016

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to the Debit/Credit Price Reasonability Checks for Complex Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 9, 2016, Chicago Board Options Exchange, Incorporated (“Exchange” or “CBOE”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to amend the debit/credit price reasonability check for complex orders. The text of the proposed rule change is provided below.

(additions are italicized; deletions are [bracketed])

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**Chicago Board Options Exchange, Incorporated
Rules**

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**Rule 6.53C. Complex Orders on the Hybrid System
(a) – (d) No change.**

... Interpretations and Policies:

.01 – .07 No change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

.08 Price Check Parameters: On a class-by-class basis, the Exchange may determine (and announce to the Trading Permit Holders via Regulatory Circular) which of the following price check parameters will apply to eligible complex orders. Paragraphs (b) and (e) will not be applicable to stock-option orders.

For purposes of this Interpretation and Policy .08:

Vertical Spread. A “vertical” spread is a two-legged complex order with one leg to buy a number of calls (puts) and one leg to sell the same number of calls (puts) with the same expiration date but different exercise prices.

Butterfly Spread. A “butterfly” spread is a three-legged complex order with two legs to buy (sell) the same number of calls (puts) and one leg to sell (buy) twice as many calls (puts), all with the same expiration date but different exercise prices, and the exercise price of the middle leg is between the exercise prices of the other legs. If the exercise price of the middle leg is halfway between the exercise prices of the other legs, it is a “true” butterfly; otherwise, it is a “skewed” butterfly.

Box Spread. A “box” spread is a four-legged complex order with one leg to buy calls and one leg to sell puts with one strike price, and one leg to sell calls and one leg to buy puts with another strike price, all of which have the same expiration date and are for the same number of contracts.

To the extent a price check parameter is applicable, the Exchange will not automatically execute an eligible complex order that is:

(a) – (b) No change.

(c) Debit/Credit Price Reasonability Checks:

(1) No change.

(2) The System defines a complex order as a debit or credit as follows:

(A) – (B) No change.

(C) an order for which all pairs and loners are debits (credits) is a debit (credit). For purposes of this check, a “pair” is a pair of legs in an order for which both legs are calls or both legs are puts, one leg is a buy and one leg is a sell, and [both]the legs have the same expiration date but different exercise prices or, for all options except European-style index options, [the same exercise price but]different expiration dates and the exercise price for the call (put) with the farther expiration date is the same as or lower (higher) than the exercise price for the nearer expiration date. A “loner” is any leg in an order that the System cannot pair with another leg in the order (including legs in orders for European-style index options that have the same exercise price but different expiration dates). The System treats the stock leg of a stock-option order as a loner.

(i) No change.

(ii) The System then, for options except European-style index options, pairs legs to the extent possible [with the same exercise prices]across expiration dates, pairing one [leg]call (put) with the [leg]call (put) that has the next nearest expiration date and the same or next lower (higher) exercise price.

(iii) A pair of calls is a credit (debit) if the exercise price of the buy (sell) leg is higher than the exercise price of the sell (buy) leg (if the pair has the same expiration date) or if the expiration date of the sell (buy) leg is farther than the expiration date of the buy (sell) leg (if the [pair has the same]exercise price of the sell (buy) leg is the same as or lower than the exercise price of the buy (sell) leg).

(iv) A pair of puts is a credit (debit) if the exercise price of the sell (buy) leg is higher than the exercise price of the buy (sell) leg (if the pair has the same expiration date) or if the expiration date of the sell (buy) leg is farther than the expiration date of the buy (sell) leg (if the [pair has the same]exercise price of the sell (buy) leg is the same as or higher than the exercise price of the buy (sell) leg).

(v) No change.

The System does not apply the check in subparagraph (1) to an order for which the System cannot define whether it is a debit or credit.

(3) – (6) No change.

(d) – (g) No change.

.09 – .12 No change.

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The text of the proposed rule change is also available on the Exchange's website (<http://www.cboe.com/AboutCBOE/CBOELegalRegulatoryHome.aspx>), at the Exchange's Office of the Secretary, 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, 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 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 proposed rule change amends the debit/credit price reasonability check for complex orders in Rule 6.53C, Interpretation and Policy .08(c) to expand its applicability. Pursuant to the debit/credit price reasonability check, the System rejects back to the Trading Permit Holder any limit order for a debit strategy with a net credit price or any limit order for a credit strategy with a net debit price, and cancels any market order (or any remaining size after partial execution of the order) for a credit strategy that would be executed at a net debit price. The System defines a complex order as a debit (credit) if all pairs and loners are debits (credits).³ For purposes of this check, a “pair” is a pair of legs in an order for which both legs are calls or both legs are puts, one leg is a buy and one leg is a sell, and both legs have the same expiration date but different exercise prices or, for all options except European-style index options, the same exercise price but different expiration dates. A “loner” is any leg in an order that the System cannot pair with another leg in the order (including legs in orders for European-style index options that have the same exercise price but different expiration dates).⁴

(1) The System first pairs legs to the extent possible within each expiration date, pairing one leg with the leg that has the next highest exercise price.

(2) The System then, for options except European-style index options, pairs legs to the extent possible with the same exercise prices across expiration dates, pairing one leg with the leg that has the next nearest expiration date.

³ Rule 6.53C, Interpretation and Policy .08(c)(2)(C). The System also determines certain call and put butterfly spreads as debits and credits. See Rule 6.53C, Interpretation and Policy .08(c)(2)(A) and (B).

⁴ The System treats the stock leg of a stock-option order as a loner.

(3) A pair of calls is a credit (debit) if the exercise price of the buy (sell) leg is higher than the exercise price of the sell (buy) leg (if the pair has the same expiration date) or if the expiration date of the sell (buy) leg is farther than the expiration date of the buy (sell) leg (if the pair has the same exercise price).

(4) A pair of puts is a credit (debit) if the exercise price of the sell (buy) leg is higher than the exercise price of the buy (sell) leg (if the pair has the same expiration date) or if the expiration date of the sell (buy) leg is farther than the expiration date of the buy (sell) leg (if the pair has the same exercise price).

(5) A loner to buy is a debit, and a loner to sell is a credit.

The System does not apply the check in subparagraph (1) to an order for which the System cannot define whether it is a debit or credit.

As discussed in the rule filing proposing the current check, the System determines whether an order is a debit or credit based on general options volatility and pricing principles, which the Exchange understands are used by market participants in their option pricing models.⁵

With respect to options with the same underlying:

- if two calls have the same expiration date, the price of the call with the lower exercise price is more than the price of the call with the higher exercise price;
- if two puts have the same expiration date, the price of the put with the higher exercise price is more than the price of the put with the lower exercise price; and
- if two calls (puts) have the same exercise price, the price of the call (put) with the nearer expiration is less than the price of the call (put) with the farther expiration.

⁵ Securities Exchange Act Release No. 34-76960 (January 21, 2016), 81 FR 4728 (January 27, 2016) (SR-CBOE-2015-107) (Notice of Filing of Amendment No. 2 and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Amendment Nos. 1 and 2 Thereto, Relating to Price Protection Mechanisms for Quotes and Orders).

In other words, a call (put) with a lower (higher) exercise price is more expensive than a call (put) with a higher (lower) exercise price, because the ability to buy stock at a lower price is more valuable than the ability to buy stock at a higher price, and the ability to sell stock at a higher price is more valuable than the ability to sell stock at a lower price. A call (put) with a farther expiration is more expensive than the price of a call (put) with a nearer expiration, because locking in a price further into the future involves more risk for the buyer and seller and thus is more valuable, making an option (call or put) with a farther expiration more expensive than an option with a nearer expiration.

Under the current check, the System only pairs calls (puts) if they have the same expiration date but different exercise prices or the same exercise price but different expiration dates. With respect to pairs with different expiration dates but the same exercise price,⁶ a pair of calls is a credit (debit) strategy if the expiration date of the sell (buy) leg is farther than the expiration date of the buy (sell) leg[sic], and a pair of puts is a credit (debit) strategy if the expiration date of the sell (buy) leg is farther than the expiration date of the buy (sell) leg[sic]. However, based on the principles described above, if the sell (buy) leg of a pair of calls has a farther expiration date (and thus is more expensive) than the expiration date of the buy (sell) leg as well as a lower exercise price (and thus is more expensive) than the exercise price of the sell (buy) leg, then the pair is a credit (debit) (as is the case if the exercise prices of each call were the same under the current rule). Similarly, if the sell (buy) leg of a pair of puts has a farther expiration date (and thus is more expensive) than the expiration date of the buy (sell) leg as well as a higher exercise price (and thus is more expensive) than the exercise price of the buy (sell)

⁶ A complex order consisting of a buy leg and a sell leg with different expiration dates are commonly referred to in the industry as “calendar spreads.”

leg, then the pair of puts is a credit (as is the case if the exercise prices of each put were the same under the current rule).

Therefore, the proposed rule change expands this check to pair calls (puts) with different expiration dates if the exercise price for the call (put) with the farther expiration date is lower (higher) than the exercise price for the nearer expiration date in addition to those with different expiration dates and the same exercise price. Specifically, the proposed rule change amends subparagraph (c)(2)(C) to state, for purposes of this check, a “pair” is a pair of legs in an order for which both legs are calls or both legs are puts, one leg is a buy and one leg is a sell, and the legs have different expiration dates and the exercise price for the call (put) with the farther expiration date is the same as or lower (higher) than the exercise price for the nearer expiration date. The proposed rule change also amends subparagraphs (c)(2)(C)(ii) through (iv) to incorporate these additional pairs of calls (puts). When pairing legs across expiration dates, the System will pair one call (put) with the call (put) that has the next nearest expiration date and the same or next lower (higher) exercise price. Based on the pricing principles described above, a pair of calls is a credit (debit) strategy if the expiration date of the sell (buy) leg is farther than the expiration date of the buy (sell) leg (if the exercise price of the sell (buy) leg is the same as or lower than the exercise price of the buy (sell) leg). A pair of puts is a credit (debit) strategy if the expiration date of the sell (buy) leg is farther than the expiration date of the buy (sell) leg (if the exercise price of the sell (buy) leg is the same as or higher than the exercise price of the buy (sell) leg).⁷ Entering a calendar spread with a credit (debit) strategy at a debit (credit) price (or

⁷ The proposed rule change makes no changes to this check with respect to pairs of orders with the same expiration date but different exercise prices. Therefore, the rule filing omits references to the portions of the current rule related to those pairs to focus on the changes made to pairs with different expiration dates.

that would execute at a debit (credit) price), which price is inconsistent with the strategy, may result in executions at prices that are extreme and potentially erroneous.

Below are examples demonstrating how the System determines whether a complex order with two legs, which have different expiration dates and exercise prices, is a debit or credit, and whether the System will reject the order pursuant to the debit/credit price reasonability check.⁸

Example #1 – Limit Call Spread

A Trading Permit Holder enters a spread to buy 10 Sept 30 XYZ calls and sell 10 Oct 20 XYZ calls at a net debit price of -\$10.00. The System defines this order as a credit, because the buy leg is for the call with the nearer expiration date and higher exercise price (and is thus the less expensive leg). The System rejects the order back to the Trading Permit Holder because it is a limit order for a credit strategy that contains a net debit price.

Example #2 – Limit Put Spread

A Trading Permit Holder enters a spread to buy 20 Oct 30 XYZ puts and sell 20 Sept 20 XYZ puts at a net credit price of \$9.00. The System defines this order as a debit, because the buy leg is for the put with the farther expiration date and the higher exercise price (and thus the more expensive leg). The System rejects the order back to the Trading Permit Holder because it is a limit order for a debit strategy that contains a net credit price.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to the Exchange and, in particular, the requirements of Section 6(b) of the Act.⁹ Specifically, the Exchange believes the proposed rule change is

⁸ The same principles would apply to complex orders with more than two legs, which include two legs that can be paired in this way.

⁹ 15 U.S.C. 78f(b).

consistent with the Section 6(b)(5)¹⁰ 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 respect to, and facilitating 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)¹¹ requirement that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

In particular, the proposed rule change expands the applicability of the current debit/credit price reasonability check to additional complex orders for which the Exchange can determine whether the order is a debit or credit. By expanding the orders to which these checks apply, the Exchange can further assist with the maintenance of a fair and orderly market by mitigating the potential risks associated with additional complex orders trading at prices that are inconsistent with their strategies (which may result in executions at prices that are extreme and potentially erroneous), which ultimately protects investors. This proposed expansion of the debit/credit price reasonability check promotes just and equitable principles of trade, as it is based on the same general option and volatility pricing principles the System currently uses to price calls and puts, which principles the Exchange understands are used by market participants in their option pricing models.

¹⁰ 15 U.S.C. 78f(b)(5).

¹¹ Id.

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

CBOE 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 rule change will not impose any burden on intramarket competition, because the debit/credit price reasonability check will continue to apply to all incoming complex orders of all Trading Permit Holders in the same manner. The proposed rule change expands the applicability of the current check to additional complex orders for which the Exchange can determine whether the order is a debit or credit, which will help further prevent potentially erroneous executions and benefits all market participants. The proposed rule change does not impose any burden on intercompany competition, as it is intended to prevent potentially erroneously priced orders from entering CBOE's system and executing on CBOE's market. The Exchange believes the proposed rule change would ultimately provide all market participants with additional protection from anomalous or erroneous executions.

The individual firm benefits of enhanced risk protections flow downstream to counterparties both at the Exchange and at other options exchanges, which increases systemic protections as well. The Exchange believes enhancing risk protections will allow Trading Permit Holders to enter orders and quotes with further reduced fear of inadvertent exposure to excessive risk, which will benefit investors through increased liquidity for the execution of their orders. Without adequate risk management tools, such as the one proposed to be enhanced in this filing, Trading Permit Holders could reduce the amount of order flow and liquidity they provide. Such actions may undermine the quality of the markets available to customers and other market participants. Accordingly, the proposed rule change is designed to encourage Trading Permit Holders to submit additional order flow and liquidity to the Exchange, which may ultimately

promote competition. In addition, providing Trading Permit Holders with more tools for managing risk will facilitate transactions in securities because, as noted above, Trading Permit Holders will have more confidence protections are in place that reduce the risks from potential system errors and market events.

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act¹² and Rule 19b-4(f)(6) thereunder.¹³

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is: (1) necessary or appropriate in the public interest; (2) for the protection of investors; or (3) otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule change should be approved or disapproved.

¹² 15 U.S.C. 78s(b)(3)(A).

¹³ 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change, along with a brief description and the text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

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-CBOE-2016-086 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-2016-086. 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, D.C. 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-2016-086 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.¹⁴

Eduardo A. Aleman
Assistant Secretary

¹⁴ 17 CFR 200.30-3(a)(12).

