

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-77848; File No. SR-CBOE-2016-024]

### Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving Proposed Rule Change, as Modified by Amendment No. 2 Thereto, Relating to AIM Retained Orders

May 17, 2016.

#### I. Introduction

On March 22, 2016, Chicago Board Options Exchange, Incorporated (the “Exchange” or “CBOE”) filed with the Securities and Exchange Commission (“Commission”) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”) <sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to codify the Exchange’s Automated Improvement Mechanism (“AIM”) Retained Order functionality in its rules. On April 1, 2016, the Exchange filed Amendment No. 1 to the proposal. On April 4, 2016, the Exchange filed Amendment No. 2 to the proposal.<sup>3</sup> The proposed rule change, as modified by Amendment No. 2, was published for comment in the **Federal Register** on April 8, 2016.<sup>4</sup> No comment letters were received on the proposed rule change. This order approves the proposed rule change, as modified by Amendment No. 2.

#### II. Description of the Proposed Rule Change

Under CBOE Rule 6.74A, a Trading Permit Holder (“TPH”) that represents agency orders may electronically execute an order it represents as agent (“Agency Order”) against principal interest or against a solicited order provided it submits the Agency Order for electronic execution into the AIM auction (“Auction”) for processing. If certain eligibility requirements contained in CBOE Rule 6.74A(a) <sup>5</sup> are

not satisfied, then both the Agency Order and the matching contra order(s) will be cancelled.

The AIM Retained Order (“A:AIR”) functionality allows TPHs the ability to choose, on an order-by-order basis, whether an Agency Order should continue into the Hybrid Trading System <sup>6</sup> for processing rather than cancel in the event that an Auction cannot occur.<sup>7</sup> Specifically, the Exchange proposes to define an AIM Retained Order as the transmission of two or more orders for crossing pursuant to CBOE Rule 6.74A, with the Agency Order priced at the market or a limit price in the standard increment for the option series and marked with a contingency instruction to route the Agency Order for processing and cancel any contra orders if an Auction cannot occur (including if the conditions described in CBOE Rule 6.74A(a) are not met).

CBOE also proposes that orders marked “A:AIR” containing Agency Orders that are not priced at the market, or that are priced with a limit price not in the standard increment for the option series in which they are entered, would be cancelled. The Exchange proposes this interpretation to ensure that A:AIR orders are properly priced to allow the Exchange to book the Agency Order in the event an Auction cannot occur.<sup>8</sup>

CBOE proposes to make the A:AIR order functionality available on those order management platforms as determined by the Exchange and announced via Regulatory Circular. The Exchange also proposes to clarify that in the event that a TPH submits a matched Agency Order for electronic execution into the Auction that is ineligible for processing because it does not meet the conditions described in CBOE Rule 6.74A(a), both the Agency Order and any solicited contra orders will be cancelled unless marked as an AIM Retained Order pursuant to proposed

Interpretation and Policy .09 to CBOE Rule 6.74A.<sup>9</sup>

Finally, the Exchange proposes to make changes to Interpretation and Policy .08 to CBOE Rule 6.53C regarding price reasonability checks on complex orders to harmonize non-specific references to the current A:AIR functionality in CBOE Rule 6.53C with the language in proposed Interpretation and Policy .09 to CBOE Rule 6.74A. The Exchange states that these changes are non-substantive and intended only to harmonize existing references to A:AIR functionality in its rules with the definition of A:AIR orders set forth in proposed Interpretation and Policy .09 to CBOE Rule 6.74A.<sup>10</sup>

#### III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>11</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>12</sup> which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in 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 and that the rules not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers. In particular, the Commission notes that, according to the Exchange, the A:AIR functionality provides an execution opportunity for customer orders that a TPH submitted for crossing via AIM but

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

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

<sup>3</sup> Amendment No. 2 superseded Amendment No. 1 in its entirety.

<sup>4</sup> See Securities Exchange Act Release No. 77511 (April 4, 2016), 81 FR 20697 (“Notice”).

<sup>5</sup> Specifically, to be eligible for processing via AIM, the Agency Order must be: (1) In a class designated as eligible for Auctions and within the designated eligibility size parameters as determined by the Exchange; (2) stopped with a principal or solicited order priced at the national best bid or offer (“NBBO”) (if 50 standard option contracts or 500 mini-option contracts or greater) or one cent/one minimum increment better than the NBBO (if less than 50 standard option contracts or 500 mini-option contracts); and (3) submitted in a series in which at least three Market-Makers are quoting if submitted during regular trading hours. See CBOE Rule 6.74A(a).

<sup>6</sup> The Hybrid Trading System refers to the Exchange’s trading platform as defined in Rule 1.1(aaa) (Hybrid Trading System).

<sup>7</sup> According to the Exchange, there are a variety of circumstances in which an AIM order may be submitted to the Exchange for processing, but an auction may not occur. For example, a TPH may submit an order for AIM processing that is not AIM eligible because one or more of the conditions required for an AIM auction to occur pursuant to Rule 6.74A(a) is not present. In addition, an order that is otherwise AIM eligible may not be able to process for a variety of reasons, including, but not limited to circumstances in which AIM functionality is suspended. In either of such cases, A:AIR functionality may allow the Agency Order to process despite the overall order not being AIM eligible. See Notice, *supra* note 4, at 20698.

<sup>8</sup> See Notice, *supra* note 4, at 20698.

<sup>9</sup> According to the Exchange, the current A:AIR functionality is used primarily by smart router technology to ensure that ineligible AIM orders are submitted into the Hybrid Trading System for processing and not cancelled. See Notice, *supra* note 4, at 20698. Whereas traditional brokers and dealers are equipped to manually handle cancelled orders that are returned to them and may revise the cancelled orders’ terms or contact their customers for further instructions, the Exchange states that smart routers are generally all electronic algorithmic systems that may not allow for manual handling of cancelled orders. See *id.*

<sup>10</sup> See Notice, *supra* note 4, at 20698.

<sup>11</sup> In approving this proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>12</sup> 15 U.S.C. 78f(b)(5).

cannot be executed via AIM.<sup>13</sup> Such opportunity could help protect the interest of investors by helping to ensure that ineligible AIM Agency Orders are processed, rather than cancelled.

#### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>14</sup> that the proposed rule change (SR-CBOE-2016-024), as modified by Amendment No. 2, be, and hereby is, approved.

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

**Robert W. Errett,**  
Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-77839; File No. SR-NASDAQ-2016-066]

### Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Amend Nasdaq Rule 4703

May 16, 2016.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May 4, 2016, The Nasdaq Stock Market LLC (“Nasdaq” or the “Exchange”) 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 Nasdaq. 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 Rule 4703 (Order Attributes).

The text of the proposed rule change is available at <http://nasdaq.cchwallstreet.com/>, at Nasdaq’s principal office, 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. Nasdaq 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

Nasdaq is proposing to amend Rule 4703(a)(7). This rule currently provides that a market participant entering an order using the SCAN routing strategy prior to 8:00 a.m. Eastern time (“ET”) may designate the order to activate upon entry or at 8:00 a.m. ET. The Exchange proposes to extend this functionality to the recently approved Retail Order Process (“RTFY”) order routing option.<sup>3</sup>

The RTFY order routing option is designed to enhance execution quality and benefit retail investors by providing price improvement opportunities to retail order flow. Previously, retail order firms often sent non-marketable order flow, that is—orders that are not executable against the best prices available in the market place based on their limit price—to post and display on exchanges. Some of the orders that have been deemed to be non-marketable by the entering firm become marketable by the time the exchange receives them and ultimately remove liquidity from the exchange order book. The RTFY routing option is an alternative method for posting non-marketable order flow on the Exchange order book. Rather than allowing the marketable Designated Retail Orders (“DROs”)<sup>4</sup> to immediately remove liquidity from the Exchange order book (unless explicitly instructed to do so), the order is routed to destinations in the System routing table<sup>5</sup> to increase price improvement

opportunities for the DROs. RTFY may remove liquidity from the Exchange book after routing to other destinations. Any non-marketable RTFY orders will post on the Exchange book.

Under the SCAN<sup>6</sup> routing strategy orders can check the System for available shares and simultaneously route the remaining shares to destinations on the System routing table. Shares that remain unexecuted after routing are posted on the Exchange book. Once on the Exchange book, if the order is subsequently locked or crossed by another market center, the System will not route the order to the locking or crossing market center.

Currently, RTFY users may enter extended hours orders, which may execute, route, or post to the book prior to the beginning of regular hours trading. Extended hours orders are accepted starting at 4 a.m. ET. SCAN users may also send extended hours orders which are eligible for execution, routing, and posting prior to regular market hours trading. However, SCAN users may also designate that their extended hours orders not activate until 8 a.m. Some market participants maintain systems that do not allow executions prior to 8 a.m. The Exchange believes this functionality for SCAN orders supports market participants by giving them the ability to allow orders to flow through to the Exchange while keeping them inactive until 8 a.m.

The Exchange believes that the market participants who currently use this functionality for the SCAN order routing option, as described in Nasdaq Rule 4703(a)(7), are similar to the market participants who use the new RTFY order routing option. While the users of the SCAN routing strategy are diverse, the users of the 8 a.m. activation functionality are generally retail focused broker-dealers. RTFY is an order routing option designed specifically for DROs in order to provide more opportunities for price improvement to individual retail investor’s orders. Because the firms that choose to utilize the 8 a.m. activation feature of SCAN are generally firms that represent retail orders, the Exchange believes that it makes sense to provide this functionality to the retail firms that make use of the RTFY routing option. The Exchange proposes to update the fifth bullet point under Nasdaq Rule 4703(a) for consistency as to this point as well.

The proposed rule change will allow market participants using RTFY to benefit by having the added flexibility

modify the System routing table at any time without notice. See NASDAQ Rule 4758(a)(1)(A).

<sup>6</sup> See Nasdaq Rule 4758(a)(1)(A)(iv).

<sup>13</sup> See Notice, *supra* note 4, at 20699.

<sup>14</sup> 15 U.S.C. 78s(b)(2).

<sup>15</sup> 17 CFR 200.30-3(a)(12).

<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. 76335 (Nov. 3, 2015), 80 FR 69256 (Nov. 9, 2015) (SR-NASDAQ-2015-112).

<sup>4</sup> See Nasdaq Rule 7018.

<sup>5</sup> The term “System routing table” refers to the proprietary process for determining the specific trading venues to which the System routes orders and the order in which it routes them. NASDAQ reserves the right to maintain a different System routing table for different routing options and to