SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-82168; File No. SR-CBOE-2017-057)

November 29, 2017

Self-Regulatory Organizations; Cboe Exchange, Inc.; Notice of Filing of Amendment No. 1 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change, as Amended, to Amend Interpretation and Policy .07 of Exchange Rule 4.11, Position Limits, to Increase the Position Limits for Options on Certain Exchange Traded Products

I. Introduction

On August 15, 2017, Cboe Exchange, Inc. ("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")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to amend Interpretation and Policy .07 of Exchange Rule 4.11, Position Limits, to increase the position limits for options on the following exchange traded funds ("ETFs") and exchange traded note ("ETN"): iShares China Large-Cap ETF ("FXI"), iShares MSCI EAFE ETF ("EFA"), iShares MSCI Emerging Markets ETF ("EEM"), iShares Russell 2000 ETF ("IWM"), iShares MSCI Brazil Capped ETF ("EWZ"), iShares 20+ Year Treasury Bond Fund ETF ("TLT"), iPath S&P 500 VIX Short-Term Futures ETN ("VXX"), PowerShares QQQ Trust ("QQQQ"), and iShares MSCI Japan ETF ("EWJ"). The proposed rule change was published for comment in the Federal Register on August 31, 2017.[3] On October 11, 2017, pursuant to Section 19(b)(2) of the Act,[4] the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to

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

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 81483 (August 25, 2017), 82 FR 41457 ("Notice").

4 15 U.S.C. 78s(b)(2).

approve or disapprove the proposed rule change.[5] The Commission received no comments regarding the proposal. On November 22, 2017, the Exchange submitted Amendment No. 1 to the proposed rule change.[6] The Commission is publishing this notice and order to solicit comments on the proposed rule change, as amended, from interested persons and to institute proceedings pursuant to Section 19(b)(2)(B) of the Act[7] to determine whether to approve or disapprove the proposed rule change, as amended.

II. Description of the Proposal, as Amended

Currently, position limits for options on ETFs and ETNs, such as those subject to this proposal, are determined pursuant to Exchange Rule 4.11, and, with certain exceptions, vary according to the number of outstanding shares and past six-month trading volume of the underlying stocks, ETFs, or ETNs. Options on the securities with the largest numbers of outstanding shares and trading volume have an option position limit of 250,000 contracts (with adjustments for splits, re-capitalizations, etc.) on the same side of the market; and stocks, ETFs, and ETNs with fewer outstanding shares and lower trading volume have position limits of 200,000, 75,000, 50,000, or 25,000 contracts (with adjustments for splits, re-capitalizations, etc.) on the same side of the market. Options on FXI, EFA, EWZ, TLT, VXX, and EWJ are currently subject to the standard position limit of 250,000 contracts as set forth in Exchange Rule 4.11.[8]

---

5 See Securities Exchange Act Release No. 81853, 82 FR 48300 (October 17, 2017). The Commission designated November 29, 2017 as the date by which the Commission shall approve or disapprove, or institute proceedings to determine whether to approve or disapprove, the proposed rule change.

6 In Amendment No. 1, the Exchange provided additional justification and analysis in support of the proposal, which is summarized below. The full text of Amendment No. 1 has been placed in the public comment file for SR-CBOE-2017-57 and is available at: https://www.sec.gov/comments/sr-cboe-2017-057/cboe2017057-2715774-161526.pdf.

7 15 U.S.C. 78s(b)(2)(B).

8 See Notice, supra note 3, at 41457. The Exchange states that FXI tracks the performance

Interpretation and Policy .07 of Exchange Rule 4.11 currently sets forth separate position limits for options on certain ETFs, including 500,000 contracts for options on EEM and IWM, and 900,000 contracts for options on QQQQ.[9]

The purpose of the proposed rule change, as amended, is to amend Interpretation and Policy .07 to Exchange Rule 4.11 to increase the position and exercise limits for options on FXI, EFA, EWZ, TLT, VXX, and EWJ to from 250,000 contracts to 500,000 contracts.[10] The Exchange further proposes to amend Interpretation and Policy .07 to Exchange Rule 4.11 to

---

of the FTSE China 50 Index, which is composed of the 50 largest Chinese stocks and EFA tracks the performance of MSCI EAFE Index, which has over 900 component securities. Id. at 41458. The Exchange also states that the MSCI EAFE Index "is designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada." Id. According to the Exchange, EWZ tracks the performance of the MSCI Brazil 25/50 Index, which is composed of shares of large and mid-size companies in Brazil and TLT tracks the performance of ICE U.S. Treasury 20+ Year Bond Index, which is composed of long-term U.S. Treasury bonds. Id. The Exchange also states that VXX tracks the performance of S&P 500 VIX Short-Term Futures Index Total Return. Id. According to the Exchange, "the Index is designed to provide access to equity market volatility through CBOE Volatility Index futures. The Index offers exposure to a daily rolling long position in the first and second month VIX futures contracts and reflects market participants' views of the future direction of the VIX index at the time of expiration of the VIX futures contracts comprising the Index." Id. The Exchange also states that EWJ tracks the MSCI Japan Index, which tracks the performance of large and mid-sized companies in Japan. Id.

9 The Exchange states that EEM tracks the performance of the MSCI Emerging Markets Index, which is composed of approximately 800 component securities. According to the Exchange, the MSCI Emerging Markets Index "consists of the following 21 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey." Id. The Exchange also states that IWM tracks the performance of the Russell 2000 Index, which is composed of 2,000 small-cap domestic stocks, and QQQQ tracks the performance of the Nasdaq-100 Index, which is composed of 100 of the largest domestic and international nonfinancial companies listed on the Nasdaq Stock Market LLC. Id.

10 Pursuant to Exchange Rule 4.12, Interpretation and Policy .02, which is not being amended by the proposed rule change, the exercise limits for FXI, EFA, EWZ, TLT, VXX, and EWJ options would be similarly increased.

increase the position limits for options on EEM and IWM from 500,000 contracts to 1,000,000 contracts, and to increase the position limits for options on QQQQ from 900,000 contracts to 1,800,000 contracts.[11] The Exchange states its belief that increasing position limits for the options subject to this proposal will lead to a more liquid and competitive market environment for these options that will benefit customers interested in this product.[12]

In support of its proposal to increase the position limits for QQQQ to 1,800,000 contracts, the Exchange compared the trading characteristics of QQQQ to that of the SPDR S&P 500 ETF ("SPY"), which currently has no position limits.[13] The Exchange states that the average daily trading volume through August 14, 2017 for QQQQ was 26.25 million shares compared to 64.63 million shares for SPY.[14] The total shares outstanding for QQQQ were 351.6 million compared to 976.23 million for SPY.[15] The fund market cap for QQQQ was $50,359.7 million compared to $240,540 million for SPY.[16]

In support of its proposal to increase the position limits for EEM and IWM from 500,000 contracts to 1,000,000 contracts, the Exchange compared the trading characteristics of EEM and

---

11 Pursuant to Exchange Rule 4.12, Interpretation and Policy .02, which is not being amended by the proposed rule change, the exercise limits for EEM, IWM, and QQQQ options would be similarly increased. The Exchange also proposes to make non-substantive corrections to the names of IWM and EEM in Rule 4.11, Interpretation and Policy .07.

12 See Notice, supra note 3, at 41459.

13 See id. at 41458. See also Exchange Rule 4.11, Interpretation and Policy .07. The Commission notes that the lack of position limits for SPY is currently subject to a pilot program. See Securities Exchange Act Release Nos. 67937 (September 27, 2012), 77 FR 60489 (October 3, 2012) (SR-CBOE-2012-091) (eliminating position and exercise limits for SPY options on a pilot basis); and 81017 (June 26, 2017), 82 FR 29960 (June 30, 2017) (SR-CBOE-2017-050) (extending the SPY pilot program to July 12, 2018).

14 See Notice, supra note 3, at 41458.

15 See id.

16 See id.

IWM to that of QQQQ, which currently has a position limit of 900,000 contracts.[17] The Exchange states that the average daily trading volume through July 31, 2017 for EEM was 52.12 million shares and IWM was 27.46 million shares compared to 26.25 million shares for QQQQ.[18] The total shares outstanding for EEM were 797.4 million and for IWM were 253.1 million compared to 351.6 million for QQQQ.[19] The fund market cap for EEM was $34,926.1 million and IWM was $35,809.1 million compared to $50,359.7 million for QQQQ.[20]

In support of its proposal to increase the position limits for FXI, EFA, EWZ, TLT, VXX, and EWJ from 250,000 contracts to 500,000 contracts, the Exchange compared the trading characteristics of FXI, EFA, EWZ, TLT, VXX, and EWJ to that of EEM and IWM, both of which currently have a position limit of 500,000 contracts.[21] The Exchange states that the average daily trading volume through July 31, 2017 for FXI was 15.08 million shares, EFA was 19.42 million shares, EWZ was 17.08 million shares, TLT was 8.53 million shares, VXX was 55.04 million shares, and EWJ was 6.06 million shares compared to 52.12 million shares for EEM and 27.46 million shares for IWM.[22] The total shares outstanding for FXI was 78.6 million, EFA was 1178.4 million, EWZ was 159.4 million, TLT was 60 million, VXX was 96.7 million, and EWJ was 303.6 million compared to 797.4 million for EEM and 253.1 million for IWM.[23] The fund market cap for FXI was $3,343.6 million, EFA was $78,870.3 million, EWZ was $6,023.4 million, TLT was $7,442.4 million, VXX was $1,085.6 million, and EWJ was

---

17 See id. See also Exchange Rule 4.11, Interpretation and Policy .07.

18 See Notice, supra note 3, at 41458-59.

19 See id. at 41459.

20 See id.

21 See id. See also Exchange Rule 4.11, Interpretation and Policy .07.

22 See Notice, supra note 3, at 41459.

23 See id.

$16,625.1 million compared to $34,926.1 million for EEM and $35,809.1 million for IWM.[24]

The Exchange notes that the options reporting requirements of Exchange Rule 4.13 would continue to be applicable to the options subject to this proposal.[25] As set forth in Exchange Rule 4.13(a), each Trading Permit Holder ("TPH") must report to the Exchange certain information in relation to any customer who, acting alone, or in concert with others, on the previous business day maintained aggregate long or short positions on the same side of the market of 200 or more contracts in any single class of option contracts dealt in on the Exchange.[26] Further, Exchange Rule 4.13(b) requires each TPH (other than an Exchange market-maker or Designated Primary Market-Maker)[27] that maintains a position in excess of 10,000 non-FLEX equity option contracts on the same side of the market, on behalf of its own account or for the account of a customer, to report to the Exchange information as to whether such positions are hedged, and provide documentation as to how such contracts are hedged.[28]

The Exchange believes that the existing surveillance procedures and reporting requirements at the Exchange, other options exchanges, and at the several clearing firms are capable of properly identifying unusual and/or illegal trading activity.[29] According to the

24 See id.

25 See id.

26 The report must include, for each such class of options, the number of option contracts comprising each such position and, in the case of short positions, whether covered or uncovered. See Exchange Rule 4.13(a).

27 According to the Exchange, market-makers (including Designated Primary Market-Makers) are exempt from the referenced reporting requirement because market-maker information can be accessed through the Exchange's market surveillance systems. See Notice, supra note 3, at 41459.

28 According to the Exchange, this information would include, but would not be limited to, the option position, whether such position is hedged and, if so, a description of the hedge, and the collateral used to carry the position, if applicable. See id.

29 See id.

Exchange, its surveillance procedures utilize daily monitoring of market movements via automated surveillance techniques to identify unusual activity in both options and underlying stocks.[30] In addition, the Exchange states that its surveillance procedures have been effective for the surveillance of trading in the options subject to this proposal, and will continue to be employed.[31]

The Exchange further states its belief that the current financial requirements imposed by the Exchange and by the Commission adequately address concerns that a TPH or its customer may try to maintain an inordinately large unhedged position in the options subject to this proposal.[32] Current margin and risk-based haircut methodologies, the Exchange states, serve to limit the size of positions maintained by any one account by increasing the margin and/or capital that a TPH must maintain for a large position held by itself or by its customer.[33] In addition, the Exchange notes that the Commission's net capital rule, Rule 15c3-1 under the Act,[34] imposes a capital charge on TPHs to the extent of any margin deficiency resulting from the higher margin requirement.[35]

---

30 See id.

31 See id. at 41459 n.23. The Exchange represents that more than 50% of the weight of the securities held by the options subject to this proposal are also subject to a comprehensive surveillance agreement ("CSA"). See id. at 41458. Additionally, the Exchange states that the component securities of the MSCI Emerging Markets Index on which EEM is based for which the primary market is in any one country that is not subject to a CSA do not represent 20% or more of the weight of the MSCI Emerging Markets Index. See id. Further, the Exchange states that the component securities of the MSCI Emerging Markets Index on which EEM is based for which the primary market is in any two countries that are not subject to CSAs do not represent 33% or more of the weight of the MSCI Emerging Markets Index. See id.

32 See id. at 41459.

33 See id. at 41459-60.

34 17 CFR 240.15c3-1.

35 See Notice, supra note 3, at 41460.

Amendment No.1

As noted above, on November 22, 2017, the Exchange filed Amendment No. 1 to the proposed rule change to provide additional justification and support for the proposal. In Amendment No. 1, the Exchange states that it submitted the proposal at the request of market participants whose on-exchange activity has been "hindered by existing position limits, causing them to be unable to provide additional liquidity not just on the Exchange, but also on other options exchanges on which they participate."[36] In further support of its proposed increases in position limits, in Amendment No. 1, the Exchange describes at length: (i) the creation and redemption process for ETFs (and a similar process for the ETN to which the proposal relates[37]); (ii) the arbitrage activity that ensues when such instruments are overpriced or are trading at a discount to the securities on which they are based and helps to keep the instrument's price in line with the value of its underlying portfolio; and (iii) how these processes serve to mitigate the potential price impact of the ETF or ETN shares that might otherwise result from increased position limits.[38]

In addition, in Amendment No. 1, the Exchange notes that some of the ETFs and the ETN to which the proposal relates are based on broad-based indices that underlie cash-settled

---

36 See Amendment No. 1 at 4-5. The Exchange reiterates its understanding that certain market participants are opting to execute trades involving large numbers of options contracts in the symbols subject to the proposal in the over-the-counter market, and argues that these large trades do not contribute to the price discovery process performed on a lit market. See id. at 5.

37 With regard to the ETN option included in the proposal – VXX – the Exchange acknowledged that there is no direct analogue to ETF "creation," but observed that the ETN issuer may sell additional VXX shares from its inventory. Regardless of whether VXX shares are redeemed or new VXX shares are issued, the Exchange stated, an issuer may transact in VIX futures in order to hedge its exposure, resulting in an arbitrage process similar to the one described for ETFs described above, thereby helping to keep an ETN's price in line with the value of its underlying index. See Amendment No. 1 at 7-8.

38 See id. at 6-7.

options that are economically equivalent to the relevant ETF or similar to the relevant ETN, but where the option on the index is either subject to no position limit or is subject to a position limit reflecting a notional value that is larger than the position limit for the option on the ETF absent the proposed increase.[39] For the other ETFs in the proposal where this does not apply, the Exchange argues that, based on the liquidity, breadth, and depth of the underlying market, the index referenced by the ETF would be considered a broad-based index under the Exchange's rules.[40] According to the Exchange, if certain position limits are appropriate for the options overlying the same index or is an analogue to the basket of securities that the ETF tracks, then those same economically equivalent position limits should be appropriate for the option overlying the ETF.[41] The Exchange believes that the new position limits it is proposing meet this criterion.[42] The Exchange also cites data in support of its argument that the market capitalization of the underlying index or reference asset of each of the ETFs and the ETN is large enough to absorb any price movements that may be caused by an oversized trade.[43]

III. Proceedings to Determine Whether to Approve or Disapprove SR-CBOE-2017-057, as Amended, and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act[44] to determine whether the proposed rule change, as amended, should be approved or disapproved. Institution of proceedings is appropriate at this time in view of the legal and policy issues raised

---

39 See id. at 8, and the Exchange's discussion of QQQQ, IWM, VXX, and EEM, and EFA, id. at 8-11.

40 See id. at 8, and the Exchange's discussion of FXI, EWZ, TLT, and EWJ, id. at 12-14.

41 See id. at 8.

42 See id. at 8-14. For each of the ETFs and the ETN subject to the proposal, the Exchange cites specific data to illustrate its argument.

43 See id. at 8-14.

44 15 U.S.C. 78s(b)(2)(B).

by the proposal, 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 below, the Commission seeks and encourages interested persons to provide comment on the proposed rule change, as amended.

Pursuant to Section 19(b)(2)(B) of the Act,[45] the Commission is providing notice of the grounds for disapproval under consideration. The Commission notes that position and exercise limits serve as a regulatory tool designed to address manipulative schemes and adverse market impact surrounding the use of options.[46] As discussed above, the Exchange has proposed to increase the position and exercise limits for options on FXI, EFA, EWZ, TLT, VXX, and EWJ from 250,000 contracts to 500,000 contracts, for options on EEM and IWM from 500,000 contracts to 1,000,000 contracts, and for options on QQQQ from 900,000 contracts to 1,800,000 contracts. The proposed increase in position and exercise limits for each marks a substantial increase from current levels, for which the Exchange recently has provided additional justification and analysis.[47]

The Commission is instituting proceedings to allow for additional analysis of, and input from commenters with respect to, the consistency of the proposed rule change, as amended, with Section 6(b)(5) of the Act,[48] which requires 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 remove impediments to and perfect the mechanism of a free and open

---

45 Id.

46 See, e.g., Securities Exchange Act Release No. 68086 (October 23, 2012), 77 FR 65600 (October 29, 2012) (SR-CBOE-2012-066).

47 The Commission notes that the Exchange filed Amendment No. 1 to provide additional justification and analysis in support of the proposed position and exercise limits on November 22, 2017. See supra note 6.

48 15 U.S.C. 78f(b)(5).

market and a national market system and, in general, to protect investors and the public interest, and not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their data, views, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposal. In particular, the Commission invites the written views of interested persons concerning whether the proposed rule change, as amended, is consistent with Section 6(b)(5), 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 data, views, and arguments, the Commission will consider, pursuant to Rule 19b-4 under the Act,[49] any request for an opportunity to make an oral presentation.[50]

The Commission asks that commenters address the sufficiency and merit of the Exchange's statements in support of the proposal, as amended, in addition to any other comments they may wish to submit about the proposed rule change. In particular, the Commission seeks comment on whether the position and exercise limit for each option as proposed could impact markets adversely.

---

[49] 17 CFR 240.19b-4.

[50] Section 19(b)(2) of the Act, as amended by the Securities Acts 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 Acts Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule change, as amended, should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register]. 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 No. SR-CBOE-2017-057 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 No. SR-CBOE-2017-057. The 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, as amended, that are filed with the Commission, and all written communications relating to the proposed rule change, as amended, 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 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. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File No. SR-CBOE-2017-057 and should be submitted by [insert date 21 days from the date of publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[51]

Eduardo A. Aleman
Assistant Secretary

[51] 17 CFR 200.30-3(a)(12); 17 CFR 200.30-3(a)(57).