

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-89931; File No. SR-CBOE-2020-055)

September 21, 2020

Self-Regulatory Organizations; Cboe Exchange, Inc.; Notice of Filing of Amendment No. 2 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change, as Modified by Amendment No. 2, to Amend Rule 5.24

I. Introduction

On June 12, 2020, Cboe Exchange, Inc. (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”),¹ and Rule 19b-4 thereunder,² a proposed rule change to adopt Rule 5.24(e)(3) to make available an audio and video communication program to serve as a “virtual trading floor” in one or more option classes during regular trading hours. The proposed rule change was published for comment in the Federal Register on June 29, 2020.³ On July 23, 2020, the Exchange filed Amendment No. 1 to the proposed rule change.⁴ On August 10, 2020, the Commission designated a longer period for Commission action on the proposed rule change, until September 27, 2020.⁵ On August 21, 2020, the Exchange filed Amendment No. 2 to the proposed rule change, which replaced and superseded the proposed rule change, as modified by

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 89131 (June 29, 2020), 85 FR 38951 (“Notice”).

⁴ In Amendment No. 1, the Exchange revised the proposal to: (i) clarify that if the virtual trading floor is available in a class, the temporary rules in CBOE Rule 5.24(e)(1) will not apply to that class and (ii) permit clerks to access the virtual trading floor. Amendment No. 1 is available at: <https://www.sec.gov/comments/sr-cboe-2020-055/srcboe2020055-7470763-221281.pdf>.

⁵ See Securities Exchange Act Release No. 89514 (August 10, 2020), 85 FR 49696 (August 14, 2020).

Amendment No. 1.⁶ The Commission has received one comment letter on the proposal.⁷ The Commission is publishing this notice and order to solicit comments on the proposed rule change, as modified by Amendment No. 2, from interested persons and to institute proceedings pursuant to Section 19(b)(2)(B) of the Act⁸ to determine whether to approve or disapprove the proposed rule change, as modified by Amendment No. 2.

II. Description of the Proposed Rule Change, as Modified by Amendment No. 2

The Exchange proposes to amend Rule 5.24 regarding the Exchange's business continuity and disaster recovery plans. Specifically, Rule 5.24(e) provides that if the Exchange trading floor becomes inoperable, the Exchange will continue to operate in a screen-based only environment using a floorless configuration of the system that is operational while the trading floor facility is inoperable. The Exchange would operate using that configuration only until the Exchange's trading floor facility became operational.⁹ Open outcry trading would currently not be available in the event the trading floor becomes inoperable.¹⁰ In the event that the trading

⁶ In Amendment No. 2, the Exchange revised the proposal to: (i) eliminate access to the virtual trading floor when the physical trading floor is operating in a modified state; (ii) provide additional description of several aspects of the proposal, including access to the virtual trading floor, recordkeeping of all chats in the virtual trading floor, regulatory surveillance of the virtual trading floor; and (iii) make technical and conforming changes. Amendment No. 2 is available on the Commission's website at: <https://www.sec.gov/comments/sr-cboe-2020-055/srcboe2020055-7741240-223109.pdf>.

⁷ See letter to Secretary, Commission, from Kevin Kennedy, Senior Vice President, North American Markets, Nasdaq, dated July 10, 2020, available at <https://www.sec.gov/comments/sr-cboe-2020-055/srcboe2020055-7409704-219196.pdf> ("Nasdaq Letter"). The Nasdaq Letter expressed support for CBOE's proposal, but raised questions about whether options classes should be able to trade in both virtual and floor-based trading environments and whether the virtual trading floor raises liquidity and access concerns.

⁸ 15 U.S.C. 78s(b)(2)(B).

⁹ See CBOE Rule 5.24(e).

¹⁰ See id.

floor becomes inoperable, trading will be conducted pursuant to all applicable system rules, except that open outcry rules would not be in force, including but not limited to the rules (or applicable portions) in Chapter 5, Section G,¹¹ and that all non-trading rules of the Exchange would continue to apply.¹²

On March 16, 2020, the Exchange suspended open outcry trading to help prevent the spread of COVID-19.¹³ The Exchange operated in an all-electronic configuration until it reopened its trading floor on June 15, 2020, at which time the Exchange returned to operating as a hybrid exchange with electronic and open outcry trading.¹⁴ However, given the uncertainty related to the ongoing pandemic, which includes the possibility of the Exchange having to close its trading floor again, and given the possibility that the Exchange's trading floor may be inoperable for other reasons in the future, the Exchange proposes to adopt Rule 5.24(e)(3) to

¹¹ Chapter 5, Section G of the Exchange's rulebook sets forth the rules and procedures for manual order handling and open outcry trading on the Exchange.

¹² The Exchange recently adopted several rule changes that would apply during a time in which the trading floor is inoperable, which are effective until September 30, 2020. See, e.g., Securities Exchange Act Release Nos. 88386 (March 13, 2020), 85 FR 15823 (March 19, 2020) (SR-CBOE-2020-019); 88447 (March 20, 2020) (SR-CBOE-2020-023); 88490 (March 26, 2020), 85 FR 18318 (April 1, 2020) (SR-CBOE-2020-026); 88530 (March 31, 2020), 85 FR 19182 (April 6, 2020) (SR-CBOE-2020-031); 88886 (May 15, 2020), 85 FR 31008 (May 21, 2020) (SR-CBOE-2020-047); 89307 (July 14, 2020), 85 FR 43938 (July 20, 2020) (SR-CBOE-2020-066); and 89789 (September 8, 2020), 85 FR 56658 (September 14, 2020) (SR-CBOE-2020-081).

¹³ See supra note 6, at 5.

¹⁴ See id.

permit it to make available an audio and video communication program to serve as a “virtual trading floor” in one or more option classes¹⁵ if the physical trading floor is inoperable.¹⁶

In the program, the Exchange would create “virtual trading pits,” in each of which the Exchange would determine which options class(es) would be available for trading.¹⁷ In a virtual trading pit, each Trading Permit Holder (“TPH”) authorized to access the virtual trading floor (as described below) that enters the virtual trading pit would be visible to all other TPHs in that virtual trading pit.¹⁸ Additionally, all TPHs in a virtual trading pit may speak to each other through the proposed communication program.¹⁹ The Exchange states that this would provide the same communication capabilities TPHs generally have on the physical trading floor so that they may conduct open outcry trading on the virtual trading floor in the same manner as they do on the physical trading floor.²⁰

Proposed Rule 5.24(e)(3) states that all rules related to open outcry trading, including those in Chapter 5, Section G,²¹ would apply to open outcry trading on the virtual trading floor in

¹⁵ Similar to open outcry trading on the physical trading floor, open outcry trading on the virtual trading floor would be available only during Regular Trading Hours. See proposed CBOE Rule 5.24(e)(3).

¹⁶ The Exchange states that, while the recent amendments to Rule 5.24(e)(1) allowed all-electronic trading to occur more similarly to open outcry trading, an all-electronic trading environment cannot fully replicate open outcry trading. See supra note 6, at 5. For example, the Exchange states that there are certain features of open outcry trading that have been difficult to replicate in an electronic trading environment, particularly the human interaction that permits persons to negotiate pricing and to facilitate executions of larger orders and high-risk and complicated strategies. See id. at 6.

¹⁷ The Exchange states that this is similar to the Exchange’s authority with respect to open outcry trading on the physical trading floor. See id. at 6, n.6.

¹⁸ See id. at 7.

¹⁹ See id.

²⁰ See id.

²¹ See supra note 11.

the same manner as they apply to open outcry trading on the physical trading floor, except as the context otherwise requires and as set forth in proposed subparagraph (e)(3). Proposed subparagraph (e)(3)(A) lists certain terms in the rules related to open outcry trading on the physical trading floor that would be deemed to refer to corresponding terms related to open outcry trading on the virtual trading floor. Specifically:

- References in the rules to the “floor,” “trading floor,” and “Exchange floor” (and any other terms with the same meaning) would be deemed to refer to the “virtual trading floor.”
- References in the rules to “pit,” “trading station,” and “trading post” (and any other terms with the same meaning) would be deemed to refer to a “virtual trading pit.”
- References in the rules to “physical presence” (any other terms with the same meaning) in a pit or on the trading floor would be deemed to refer to “presence” in a virtual trading pit or on the virtual trading floor, respectively.
- The terms “in-crowd market participant” and “ICMP” mean a Market-Maker, a Designated Primary Market-Maker (“DPM”) or Lead Market-Maker (“LMM”) with an allocation in a class, or a Floor Broker or PAR Official representing an order in a virtual pit on the virtual trading floor.
- References to an “on-floor DPM” or “on -floor LMM” would be deemed to refer to a DPM or LMM, respectively, in a virtual pit for its allocated class(es).

In addition, proposed Rule 5.24(e) states that the temporary rules set forth in Rule 5.24(e)(1) would not be applicable to trading in classes in which the Exchange makes a virtual trading floor available when the physical trading floor is inoperable. As noted above, the temporary rules in Rule

5.24(e)(1) are intended to make electronic trading more similar to open outcry trading when open outcry trading is not available by replicating certain features of open outcry trading in an electronic environment. However, the virtual trading floor would permit open outcry trading to continue in a separate environment if the physical trading floor becomes inoperable. Therefore, trading opportunities that are generally only available in open outcry trading would continue to be available on the virtual trading floor, making the temporary rules in Rule 5.24(e)(1) unnecessary when the virtual trading floor is available.

The Exchange represents that access to the virtual trading floor would be substantially similar to access to the physical trading floor.²² Proposed Rule 5.24(e)(3)(B) states that admission to the virtual trading floor is limited to TPHs, clerks,²³ Exchange employees, and any other persons the Exchange authorizes admission to the virtual trading floor.²⁴ The Exchange would provide access to the virtual trading floor to TPHs the Exchange has approved to perform a trading floor

²² See Notice, supra note 6, at 9. The Exchange states that, currently, admission to the physical trading floor is limited to TPHs, Exchange employees, clerks employed by TPHs and registered with the Exchange, service personnel, Exchange visitors that receive authorized admission to the trading floor pursuant to Exchange policy, and any other persons that the Exchange authorizes admission to the trading floor. See id. The proposed rule change excludes service personnel and visitors from accessing the virtual trading floor. See id. at 10.

²³ TPHs and clerks would not be required to display badges on the virtual trading floor. See proposed CBOE Rule 5.24(e)(3)(B). The virtual trading floor program would identify the TPH organization of each participant in a virtual trading pit. See Notice, supra note 6, at 11, n.16.

²⁴ The Exchange states that it does not anticipate granting any other individuals with access to the virtual trading floor outside of TPHs and Exchange personnel; however, the Exchange believes the flexibility to permit Exchange personnel to access the virtual trading floor is appropriate, such as to permit access to make updates to the communication program. See id. at 10, n.14.

function (including Floor Brokers and Market-Makers).²⁵ Each authorized individual will receive one log-in to the virtual trading floor and may be present in only one virtual trading pit at one time.²⁶ The Exchange will not require a minimum number of Market-Makers to be present for the virtual trading floor, which is consistent with the manner of operation on the physical trading floor.²⁷

Proposed Rule 5.24(e)(3)(C) states that TPHs may use any equipment (e.g., any hardware or software related to a phone, system, or other device, including an instant messaging system, e-mail system, or similar device) to access the virtual trading floor and do not need to register devices they use while on the virtual trading floor.²⁸ TPHs must use Exchange-provided equipment to access PAR workstations while transacting on the virtual trading floor.²⁹ The proposed rule change does not require TPHs to register devices they use while on the virtual trading floor.³⁰ The Exchange states that the requirements in Rule 5.81(a) would otherwise apply in the same manner

²⁵ See proposed CBOE Rule 5.24(e)(3)(B). This includes TPHs (and individuals that represent TPH organizations) that are currently authorized to perform trading floor functions, as well as any TPHs that receive such authorization in the future. See Notice, supra note 6, at 10.

²⁶ See proposed CBOE Rule 5.24(e)(3)(B).

²⁷ See Notice, supra note 6, at 10.

²⁸ See Notice, supra note 6, at 11.

²⁹ The Exchange represents that the PAR will be used and work in the same manner for the virtual trading floor as it is on the physical trading floor. See Notice, supra note 6, at 11, n.16.

³⁰ See id. at 11-12.

to the virtual trading floor as it does to the physical trading floor (to the extent the context requires).³¹

Proposed Rule 5.24(e)(3)(d) provides that the Exchange may determine to require any Market-Maker or Floor Broker in a virtual trading pit that wants to trade against an order represented for execution to express its bid or offer in a chat available in the virtual trading pit.³²

The Exchange represents that TPHs participating on the virtual trading floor would be subject to the same regulatory requirements on the virtual trading floor as they are on the physical trading floor, including those set forth in Chapters 8 and 9.³³ The Exchange states that its Regulatory Division would be able to utilize preexisting floor surveillances to surveil for the activity occurring on the virtual trading floor.³⁴ Furthermore, the Exchange states that the

³¹ The Exchange states that this would include requirements related to audit trail and record retention, prohibition on using any device for the purpose of recording activities in the virtual trading pit or maintaining an open line of continuous communication whereby a non-associated person not located in the trading crowd may continuously monitor the activities in the trading crowd, and the prohibition on using devices to disseminate quotes or last sale reports. See id. at 12.

³² The Exchange states that it will announce with sufficient advance notice to all TPHs any determination to require bids and offers to be expressed in a chat within the communication program pursuant to Rule 1.5 (such as by Exchange notice or regulatory circular). See id. at 12, n.19. The Exchange also represents that, regardless of whether it requires the chat function to be used, the Exchange will maintain records of all chats in the virtual trading floor in accordance with its self-regulatory organization record retention obligations. See id. at 13.

³³ See id. at 13.

³⁴ See id.

Regulatory Division may access the virtual trading floor if it deems necessary and appropriate, including records of any chats from the virtual trading floor, if that functionality is used.³⁵

III. Proceedings to Determine Whether to Approve or Disapprove SR-CBOE-2020-055, as Modified by Amendment No. 2, and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act³⁶ to determine whether the proposed rule change, as modified by Amendment No. 2, should be approved or disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the proposal and the comment received thereon. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved.

Pursuant to Section 19(b)(2)(B) of the Act,³⁷ the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of the proposal's consistency with the Act, including Sections 6(b)(5) and 6(b)(8) thereof,³⁸ and the rules and regulations thereunder.

³⁵ See id. at 14-15.

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

³⁷ Id.

³⁸ 15 U.S.C. 78f(b)(5) and 15 U.S.C. 78f(b)(8), respectively. Section 6(b)(5) of the Act requires that the rules of a national securities exchange be designed, among other things, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest, and not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers. Section 6(b)(8) of the Act requires that the rules of a national securities exchange not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

The Commission is instituting proceedings to further consider the proposal and the issues raised by the commenter on the proposal as it determines whether the proposed virtual trading floor is consistent with the Act and the rules and regulations thereunder.

Specifically, the Commission is providing notice of the following grounds for possible disapproval under consideration:

- Whether the Exchange has demonstrated how its proposal is consistent with Section 6(b)(5) of the Act,³⁹ which requires the rules of CBOE to not be “designed to permit unfair discrimination between customers, issuers, brokers, or dealers.”
- Whether the Exchange has demonstrated how its proposal is consistent with Section 6(b)(8) of the Act,⁴⁰ which requires that the rules of CBOE not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

Under the Commission’s Rules of Practice, the “burden to demonstrate that a proposed rule change is rule change is consistent with the [Act] and the rules and regulations issued thereunder . . . is on the [SRO] that proposed the rule change.”⁴¹ The description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding,⁴² and any failure of an SRO to provide this information may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule

³⁹ 15 U.S.C. 78f(b)(5).

⁴⁰ 15 U.S.C. 78f(b)(8).

⁴¹ Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3).

⁴² See id.

change is consistent with the Act and the applicable rules and regulations.⁴³ Moreover, “unquestioning reliance” on an SRO’s representations in a proposed rule change would not be sufficient to justify Commission approval of a proposed rule change.⁴⁴

For the reasons discussed above, the Commission believes it is appropriate to institute proceedings pursuant to Section 19(b)(2)(B) of the Act to allow for additional consideration of the issues raised by the proposal as it determines whether the proposal should be approved or disapproved.

IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the concerns identified above, as well as any others they may have with the proposal. In particular, the Commission invites the written views of interested persons concerning whether the proposed rule change, as modified by Amendment No. 2, is inconsistent with Section 6(b)(5)⁴⁵ or any other provision of the Act, or the rules and regulation thereunder. Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4 under the Act, any request for an opportunity to make an oral presentation.⁴⁶

⁴³ See id.

⁴⁴ See Susquehanna Int’l Group, LLP v. Securities and Exchange Commission, 866 F.3d 442, 446-47 (D.C. Cir. 2017) (rejecting the Commission’s reliance on an SRO’s own determinations without sufficient evidence of the basis for such determinations).

⁴⁵ 15 U.S.C. 78f(b)(5).

⁴⁶ Section 19(b)(2) of the Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants 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

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule change, as modified by Amendment No. 2, 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].

The Commission asks that commenters address the sufficiency and merit of the Exchange's statements in support of the proposed rule change, in addition to any other comments they may wish to submit about the proposed rule change. In particular, the Commission seeks comment on the statements of the Exchange contained in Amendment No. 2,⁴⁷ and any other issues raised by the proposed rule change.

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-2020-055 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-2020-055. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your

Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

⁴⁷ See Amendment No. 2, supra note 6.

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 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 Number SR-CBOE-2020-055 and should be submitted by [insert date 21 days from 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.⁴⁸

J. Matthew DeLesDernier
Assistant Secretary

⁴⁸ 17 CFR 200.30-3(a)(57) and (58).