

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-90179; File No. SR-CBOE-2020-074)

October 14, 2020

Self-Regulatory Organizations; Cboe Exchange, Inc.; Order Granting Approval of a Proposed Rule Change to Adopt Position Compression Cross (“PCC”) Orders for SPX

I. Introduction

On August 19, 2020, Cboe Exchange, Inc. (the “Exchange” or “Cboe Options”) 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 adopt Position Compression Cross (“PCC”) orders for S&P 500 Index (“SPX”) options. The proposed rule change was published for comment in the Federal Register on September 3, 2020.<sup>3</sup> The Commission received four comments in support of the proposed rule change.<sup>4</sup> This order approves the proposed rule change.

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<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. 89707 (August 28, 2020), 85 FR 55040 (“Notice”).

<sup>4</sup> See Letter to Vanessa Countryman, Secretary, Commission, dated September 17, 2020, from Steve Crutchfield, Head of Market Structure, CTC, LLC, available at <https://www.sec.gov/comments/sr-cboe-2020-074/srcboe2020074-7794086-223555.pdf>; Letter to Vanessa Countryman, Secretary, Commission, dated September 18, 2020, from Joanna Mallers, Secretary, FIA Principal Traders Group, available at <https://www.sec.gov/comments/sr-cboe-2020-074/srcboe2020074-7793926-223553.pdf>; Letter to Vanessa Countryman, Secretary, Commission, dated September 18, 2020, from Michael Golding, Head of Trading, Optiver US LLC, and Rutger Brinkhuis, Head of Trading, AMS Derivatives B.V., available at <https://www.sec.gov/comments/sr-cboe-2020-074/srcboe2020074-7793838-223548.pdf>; and Comment from Erik Swanson, CEO, Simplex Trading, LLC, dated September 18, 2020, available at <https://www.sec.gov/comments/sr-cboe-2020-074/srcboe2020074-7793878-223549.htm>.

## II. Summary of the Proposal

As described in more detail in the Notice,<sup>5</sup> the Exchange proposes to adopt PCC orders to assist Trading Permit Holders (“TPHs”) in reducing their open positions in series of SPX options to reduce the required capital associated with their open SPX positions. The Exchange currently facilitates compression forums on the trading floor at the end of each calendar week, month, and quarter, where TPHs can seek to reduce their open positions in SPX.<sup>6</sup> These SPX compression forums allow TPHs and their clearing firms to reduce open interest in offsetting SPX positions, which can help clearing brokers that are affiliates of bank holding companies comply with the unique regulatory capital requirements that apply to them. In turn, compression forums may help some firms, particularly market makers, mitigate the effects of capital constraints and provide them with continued access to the capital they need through their clearing brokers to provide liquidity during periods of volatility.

From March 16 to June 12, 2020, the Exchange closed its trading floor in response to the coronavirus pandemic, and as a result, the Exchange operated in an all-electronic configuration.<sup>7</sup> Because the trading floor was closed during this time, market participants could not participate in open outcry compression forums. To enable TPHs to reduce open interest in SPX options in electronic compression forums when the floor was closed, the Exchange adopted Rule 5.24(e)(1)(E) as part of its Disaster Recovery rule.<sup>8</sup>

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<sup>5</sup> See Notice, supra note 3.

<sup>6</sup> See id. at 55040. See also Cboe Rule 5.88.

<sup>7</sup> See id. at 55041.

<sup>8</sup> See Securities Exchange Act Release No. 88490 (March 26, 2020), 85 FR 18318 (April 1, 2020) (File No. SR-CBOE-2020-026).

Under Rule 5.24(e)(1)(E), when the Exchange’s trading floor becomes inoperable, it can conduct electronic compression forums as frequently as daily.<sup>9</sup> Those electronic compression forums permit an order in SPX option contracts to be coupled with a contra-side order(s) and be executed automatically on entry without exposure.<sup>10</sup> In order to obtain a clean cross, the orders are required to execute in accordance with the same priority principles that apply to complex orders on the Exchange.<sup>11</sup> Specifically: (i) each option leg may only execute at a price that complies with Rule 5.33(f)(2), provided that no option leg executes at the same price as a Priority Customer Order in the Simple Book; (ii) each option leg may only execute at a price at or between the national best bid or offer (“NBBO”) for the applicable series; and (iii) the execution price must be better than the price of any complex order resting in the complex order book, unless the submitted complex order was a Priority Customer Order and the resting complex order is a non-Priority Customer Order, in which case the execution price may be the same as or better than the price of the resting complex order.<sup>12</sup> If a compression order could not execute in accordance with these requirements, it would be cancelled.<sup>13</sup>

When the Cboe Options trading floor reopened on June 15, 2020, electronic compression forums were no longer available because the Exchange does not offer electronic compression forums when its trading floor is operable.<sup>14</sup>

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<sup>9</sup> See id. at 18319-20.

<sup>10</sup> See id. at 18320.

<sup>11</sup> See id.

<sup>12</sup> See id.

<sup>13</sup> See id.

<sup>14</sup> See Notice, supra note 3, at 55041.

In light of its recent experience with electronic compression forums, and the interest among certain TPHs that they continue, the Exchange proposes to adopt PCC orders for SPX on a permanent basis and delete its floor-based compression forum rule.<sup>15</sup> The proposed rule explicitly provides that PCC orders, which may be submitted for automatic electronic execution or for manual handling on the trading floor, may only be used to reduce the required capital associated with open SPX positions.<sup>16</sup>

To facilitate this proposed rule change, the Exchange first proposes to delete Rule 5.24(e)(1)(E) and reserve Rule 5.88. Second, the Exchange proposes to add PCC orders to its list of orders types under Rule 5.6(c). The procedures for submitting PCC orders will be similar to the procedures that currently apply to open outcry compression forums under Rule 5.88,<sup>17</sup> except that they will allow a clean cross for SPX without exposure either on the floor or electronically.

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<sup>15</sup> See id. at 55041-46 for a more detailed description of the proposal.

<sup>16</sup> See Rule 5.6(c). The Exchange explains that electronic PCC orders are uniquely relevant to SPX options because of the large notational value of SPX contracts and the significant open interest in them. See Notice, supra note 3, at 55040.

<sup>17</sup> The PCC order procedures for electronic and open outcry will differ slightly from the open outcry compression forum currently available under Rule 5.88. In particular, the Exchange may make PCC orders available more often than current compression forums, which take place only at the end of the week, month, and quarter. The Exchange will determine the times to permit PCC orders and will provide TPHs with reasonable and sufficient notice before doing so. Additionally, the Exchange will no longer post the compression-list position file on the Exchange's website because it does not believe those lists are used by TPHs or useful to the public. The new procedure also eliminates the step of initially providing individual position files on an anonymous basis and then requiring TPHs to consent to having their identities disclosed since most TPHs submit the compression-list positions with the goal of identifying other TPHs with offsetting positions to enable them to engage in the compression transactions. Lastly, the Exchange will provide two additional types of information in the compression-list positions sent to TPHs: series positions within a strike range determined by the Exchange and combos (i.e., purchase (sale) of a call and a sale (purchase) of a put with the same expiration date and the strike price) in addition to the currently provided multi-leg positions of vertical call spreads, vertical put spreads, and box spreads. See id. at 55042.

PCC orders will be available during regular trading hours and global trading hours.<sup>18</sup> The same execution and priority protection principles that apply under Rule 5.24(e)(1)(E) will apply to PCC orders,<sup>19</sup> and if a PCC order cannot be executed in accordance with these provisions, it will be cancelled. The PCC order type will also be available for SPX FLEX options.<sup>20</sup> Finally, the Exchange proposes to make PCC orders available for PAR routing for manual handling.<sup>21</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>22</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>23</sup> which requires, among other things, that the rules of a national securities exchange be designed 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.

The Exchange seeks to make the electronic PCC order type permanent, even when the trading floor of the Exchange is operable, and also offer the ability to submit a PCC order for manual handling on the trading floor. This order type will allow TPHs to execute clean crosses

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<sup>18</sup> See id. at 55045, n.38. See also Rules 5.32(g) and 5.33(n).

<sup>19</sup> See supra note 12 and accompanying text.

<sup>20</sup> See Notice, supra note 3, at 55045, n.38. See also Rule 5.70(a)(2).

<sup>21</sup> See id. at 55045-46. See also Rule 5.83(a) and (b); Rule 5.85.

<sup>22</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>23</sup> 15 U.S.C. 78f(b)(5).

of SPX compression forum orders without exposure and they will be available at any point during a month designated by the Exchange rather than just at the end of each calendar week, month, and quarter, as is the case under the current compression forum process.

The affiliation of clearing brokers with bank holding companies has introduced the need for liquidity providers and their clearing firms to more conservatively manage holdings to comply with applicable bank regulatory capital requirements, which particularly affects SPX options given the large notional exposure associated with holdings of SPX by liquidity providers in SPX across a large number of strikes and series. While these positions may be hedged, the applicable bank capital rules currently disregard offsets when calculating the notional value of short positions. As a result, the ability to close and “compress” positions in an efficient, cost-effective manner can help liquidity providers and their clearing firms reduce risk weighted assets and alleviate associated bank capital constraints.

The current floor-based compression forums are labor-intensive and can be inefficient as a result. The Exchange asserts that this proposal will increase the efficiency of SPX compression activity without causing any significant negative effect on price discovery or the ability of a TPH to access liquidity.<sup>24</sup> The commenters on the proposal similarly believe the proposal will increase efficiency by providing an electronic risk management tool to reduce SPX risk weighted assets, which will support the ability of SPX liquidity providers to provide displayed quotes in SPX options.<sup>25</sup> Accordingly, PCC orders can help assure the continued availability of capital to liquidity providers so that they can quote competitively with size, particularly during periods of

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<sup>24</sup> See Notice, supra note 3, at 55041.

<sup>25</sup> See supra note 4 (citing to the comment letters on the proposal).

heightened volatility, which removes impediments and supports fair and orderly markets to the benefit of investors.

The proposed PCC order type contains the same priority protections that apply under Rule 5.24(e)(1)(E) when the Exchange permits electronic compression orders as clean crosses when its trading floor is inoperable.<sup>26</sup> Likewise, PCC orders handled by floor brokers will be covered by the same protections.<sup>27</sup> Additionally, under the proposal, TPHs will be permitted to enter PCC orders in the same increment that is currently available for closing transactions in open outcry compression forums, which are increments of \$0.01.<sup>28</sup>

The Exchange states that the benefits of permitting PCC orders to execute as clean crosses greatly outweigh any detriments that may result from not exposing these orders for potential break up.<sup>29</sup> The Exchange notes that the benefits of requiring a TPH to expose an order or a proposed cross generally flow to that order, which benefits include the potential for price improvement and, for single orders, to locate contra-side liquidity.<sup>30</sup> In the case of an SPX transaction to reduce risk weighted capital for which a TPH could use the PCC order type, the representing TPH has already located the necessary liquidity prior to submitting the matches for execution, and the ability to execute the single or complex order in full to reduce risk weighted

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<sup>26</sup> See Notice, supra note 3, at 55045. The Commission also notes that the proposal only allows a TPH to use PCC orders to reduce the required capital associated with the TPH's open SPX positions and the Exchange represents that the Exchange's Regulatory Division will incorporate PCC orders into its surveillance. See id. at 55049.

<sup>27</sup> See id.

<sup>28</sup> See id. at 55043.

<sup>29</sup> See id. at 55048.

<sup>30</sup> See id.

capital is the primary concern.<sup>31</sup> Any likelihood of another TPH breaking up the PCC order could deter the order-originating TPH from entering its compression order, which would fail to achieve the aims of the compression order and thus fail to mitigate the associated capital constraints that could impact the liquidity provider's continued ability to quote SPX series.<sup>32</sup>

Based on the foregoing and for the above reasons, the Commission finds that the proposed rule change is consistent with the requirements of the Act in that it is designed 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.

#### IV. Conclusion

IT IS THEREFORE ORDERED that, pursuant to Section 19(b)(2) of the Act,<sup>33</sup> the proposed rule change (SR-CBOE-2020-074) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>34</sup>

J. Matthew DeLesDernier  
Assistant Secretary

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<sup>31</sup> See id. at 55049. See also supra note 27.

<sup>32</sup> See Notice, supra note 3, at 55049.

<sup>33</sup> 15 U.S.C. 78s(b)(2).

<sup>34</sup> 17 CFR 200.30-3(a)(12).