

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-90536; File No. SR-CBOE-2020-106)

November 30, 2020

Self-Regulatory Organizations; Cboe Exchange, Inc.; Notice of Filing of a Proposed Rule Change, as Modified by Amendment No. 1, to Amend its Rules Regarding the Minimum Increments for Electronic Bids and Offers and Exercise Prices of Certain FLEX Options and Clarify in the Rules how the System Ranks FLEX Option Bids and Offers for Allocation Purposes

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 November 16, Cboe Exchange, Inc. (“Exchange” or “Cboe Options”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change, and on November 30, 2020, the Exchange filed Amendment No. 1 to the proposed rule change, which amended and replaced the proposed rule change in its entirety. The proposed rule change, as modified by Amendment No. 1, as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change, as modified by Amendment No. 1, from interested persons.

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

Cboe Exchange, Inc. (the “Exchange” or “Cboe Options”) proposes to amend its Rules regarding the minimum increment for electronic bids and offers, as well as the minimum increment for exercise prices, of certain FLEX Options³ and clarify in the Rules how the System ranks FLEX Option bids and offers for allocation purposes (and make various other

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The term “FLEX Option” means a flexible exchange option. See Rule 1.1.

nonsubstantive, clarifying changes). This Amendment No. 1 replaces the initial rule filing in its entirety. The text of the proposed rule change is provided in Exhibit 5.

The text of the proposed rule change is 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 Exchange proposes to amend the minimum increment for bids and offers, as well as the minimum increment for exercise prices, of FLEX options submitted to an electronic FLEX auction and make conforming changes in other Rules. The Exchange also proposes to make various clarifying and nonsubstantive changes, including how the System ranks FLEX Option bids and offers for allocation purposes.

A FLEX Option⁴ series is eligible for trading on the Exchange upon submission to the system of a FLEX Order⁵ by a FLEX Trader (the "Submitting FLEX Trader")⁶ for that series

⁴ A "FLEX Option" is a flexible exchange option. See Rule 1.1.

⁵ A "FLEX Order" is an order submitted in a FLEX Option. See Rule 5.70.

⁶ See Rules 4.21(a) and 5.72(b).

pursuant to Rules 5.72 through 5.74.⁷ When submitting a FLEX Order into the system, the Submitting FLEX Trader must include the applicable terms of a FLEX Option series, including an exercise (or strike) price.⁸ The exercise price of a FLEX Option may currently be expressed as either (1) a fixed price expressed in terms of dollars and decimals or a specific index value, as applicable (which may not be smaller than \$0.01), or (2) a percentage of the closing value of the underlying equity security or index, as applicable, on the trade date (which may not be smaller than 0.01%).⁹

Pursuant to current Rule 5.4(c)(4)(B), the minimum increment for bids and offers on FLEX Options with (1) an exercise price expressed as a fixed price may not be smaller than \$0.01 and (2) an exercise price expressed as a percentage of the closing value of the underlying equity security or

⁷ Rules 5.72 through 5.74 describe the various auction mechanisms available for the trading of FLEX Options. A FLEX Order may be submitted for execution into an electronic or open outcry FLEX auction pursuant to Rule 5.72, or into a FLEX Automated Improvement Mechanism auction (“FLEX AIM Auction”) pursuant to Rule 5.73, or FLEX Solicitation Auction Mechanism auction (“FLEX SAM Auction”) pursuant to Rule 5.74.

⁸ See Rule 4.21(b) for a description of the terms of a FLEX Option series that a Submitting FLEX Trader must include in a FLEX Order.

⁹ See Rule 4.21(b)(6). While the specific minimums for the exercise price are not currently included in Rule 4.21(b)(6), that rule indicates that the System rounds the exercise price to the nearest minimum increment as set forth in Rule 5.4, and the Exchange has interpreted the rule to mean that the minimum increment for the exercise price of FLEX Options is the same as the minimum increment for bids and offers of FLEX Options. The term “trade date” as used in Rule 4.21(b)(6), as well as in the sentence for this footnote and throughout this rule filing, refers to the date on which the FLEX Option was bought or sold (i.e., the date on which the FLEX Option trade occurs). Note that the capped monthly return of a FLEX Index Option that is Cliquet-settled must be expressed in dollars and cents. See Rule 4.21(b)(5)(B)(iv) for a description of Cliquet-settled FLEX Index Options.

index on the trade date may not be smaller than 0.01%.¹⁰ The proposed rule change amends Rule 5.4(c)(4) to provide that:

(1) the minimum increment for bids and offers on a FLEX Options series if the exercise price is expressed as a fixed price may not be smaller than \$0.001 (for FLEX Orders and auction responses submitted to an electronic FLEX Auction); and

(2) the minimum increment for bids and offers on a FLEX Options series if the exercise price is expressed as a percentage of the closing value of the underlying equity security or index on the trade date may not be smaller than 0.0001% (for FLEX Orders and auction responses submitted to an electronic FLEX Auction).¹¹

Similarly, the proposed rule change amends Rule 4.21(b)(6)(A) to provide that:

(1) an exercise price expressed as a fixed price may not be in increments smaller than \$0.001 (for FLEX Orders submitted to an electronic FLEX Auction); and

(2) an exercise price expressed as a percentage of the closing value of the underlying equity security or index, as applicable, on the trade date may not be in increments smaller than 0.0001% (for FLEX Orders submitted to an electronic FLEX Auction).¹²

¹⁰ The Exchange determines the minimum increment for bids and offers on FLEX Options on a class-by-class basis. See Rule 5.4(c)(4).

¹¹ The proposed rule change will have no impact on the minimum increment for bids and offers for open outcry FLEX Orders and auction responses, which minimum increment for bids and offers will continue to be \$0.01 (if the exercise price for the FLEX Option series is a fixed price) or 0.01% (if the exercise price for the FLEX Option series is a percentage of the closing value of the underlying equity security or index on the trade date). The proposed rule change adds language to clarify that these minimum increments for bids and offers will continue to apply to FLEX Orders and auction responses submitted to an open outcry auction. See proposed Rule 5.4(c)(4)(B).

¹² The proposed rule change will have no impact on the smallest increment for exercise prices for open outcry FLEX Orders and auction responses, which may be no smaller than \$0.01 (if the exercise price for the FLEX Option series is a fixed price) or 0.01% (if the exercise price for the FLEX Option series is a percentage of the closing value of the underlying equity security or index on the trade date). The proposed rule change adds

The Exchange believes there is a demand from customers for this additional precision regarding the exercise prices and premiums for FLEX Options series that are submitted into electronic FLEX Auctions. This additional level of precision will provide investors with additional flexibility regarding the prices at which they may execute and exercise their FLEX Options on the Exchange, as investors may execute and exercise over-the-counter options with similar precisions.

Current Rule 4.21(b)(6) defines the permissible exercise prices for FLEX Options by referencing the minimum increments for bids and offers set forth in Rule 5.4. Specifically, the current rule states the exercise price (which the System rounds to the nearest minimum increment for bids and offers, as set forth in Rule 5.4) may be a fixed price expressed in terms of dollars and decimals or a specific index value, as applicable, or a percentage of the closing value of the underlying equity security or index, as applicable, on the trade date. As noted above, current Rule 5.4(c)(4) states that the Exchange may determine the minimum increment for bids and offers on a class-by-class basis, which may not be smaller than \$0.01 or 0.01%, as applicable. The Exchange has historically interpreted that current Rule 4.21(b)(6), by reference to current Rule 5.4(c)(4), provides that exercise prices may similarly be in increments no smaller than \$0.01 or 0.01%, as applicable, which smallest increment for exercise prices the Exchange may determine on a class-by-class basis. The proposed rule change amends Rule 4.21(b)(6) to codify this longstanding interpretation by expressly stating the actual permissible smallest increments for exercise prices and that the Exchange may determine the smallest increment for exercise prices on a class-by-class basis.

language to clarify that these minimum increments for bids and offers will continue to apply to FLEX Orders and auction responses submitted to an open outcry auction. See proposed Rule 4.21(b)(6)(A).

In connection with this proposed change to add precision to exercise prices and pricing of FLEX Options, the proposed rule change makes the following nonsubstantive changes to Rules 4.21(b)(6) and Rule 5.4(c)(4), which nonsubstantive changes further clarify differences between FLEX Option series with exercise prices expressed as fixed increments and percentages, as well as add current rule interpretations and general transparency to the Rules:

- The proposed rule change specifies the actual permissible minimum amounts for exercise prices for FLEX Equity Options or FLEX Index Options that are not Cliquet-settled rather than identifying them by reference to Rule 5.4, which defines permissible minimum increments for bids and offers. As noted above, current Rule 4.21(b)(6) states the exercise price (which the System rounds to the nearest minimum increment as set forth in Rule 5.4), which may be for a FLEX Equity Option or FLEX Index Option that is not Cliquet-settled, a fixed price expressed in terms of dollars and decimals or a specific index value, as applicable, or a percentage of the closing value of the underlying equity security or index, as applicable, on the trade date. As discussed above, the Exchange has historically interpreted this rule to mean that the smallest permissible increments for exercise prices of FLEX Options are the same as the minimum increments for bids and offers of FLEX Options, which smallest increments the Exchange may determine on a class-by-class basis (as the Exchange may do for minimum increments for bids and offers). Rather than identify the minimum increments for exercise prices by reference to the rule describing the minimum increments for bids and offers, the proposed rule change adds the language specifying the actual minimum increments for exercise prices for FLEX Equity Options and FLEX Index Options that are not Cliquet-settled, which minimum increments are the same as minimum increments for bids and offers. Specifically, the proposed rule change states that the

exercise price may be in increments no smaller than (which language is taken from Rule 5.4(c)(4)) (1) for a FLEX Equity Option or FLEX Index Option that is not Cliquet-settled, (a) \$0.001 (for FLEX Orders submitted to an electronic FLEX Auction) or \$0.01 (for FLEX Orders and auction responses submitted to an open outcry auction), if the exercise price for the FLEX Option series is a fixed price, or (b) 0.0001% (for FLEX Orders and auction responses submitted to an electronic auction) or 0.01% (for FLEX Orders and auction responses submitted to an open outcry auction), if the exercise price for the FLEX Option series is a percentage of the closing value of the underlying equity security or index on the trade date. As discussed above, the proposed rule change amends the permissible minimum amounts for exercise prices for FLEX Orders submitted to an electronic FLEX Auction. However, the minimum permissible amounts of \$0.01 and 0.01% for FLEX Options with fixed exercise prices and percentage exercise prices, respectively, submitted into open outcry FLEX Auctions added to Rule 4.21(b)(6) are the current minimum increments permissible for these FLEX Options. Therefore, the proposed rule change makes no substantive changes to the minimum increments of exercise prices for FLEX Orders submitted into open outcry FLEX Auctions. The Exchange believes this will make the rule regarding permissible exercise prices for FLEX Options more transparent and thus may eliminate potential confusion regarding permissible exercise prices.

- The proposed rule change adds to the end of Rule 4.21(b)(6) that the Exchange may determine the smallest increment for exercise prices of FLEX Options on a class-by-class basis. As discussed above, this is consistent with the Exchange's longstanding interpretation of the current Rule, which refers to the minimum increment for bids and offers as set forth in Rule 5.4 when identifying the minimum increments for exercise prices of FLEX Options.

Rule 5.4(c)(4) states that the Exchange may determine the minimum increment for bids and offers on FLEX Options on a class-by-class basis, which may be no smaller than the amounts specified in that rule. Therefore, the Exchange has interpreted Rule 4.21(b)(6) to mean that those same provisions apply to the minimum increments for exercise prices for FLEX Options. The proposed rule change codifies this longstanding interpretation in the Rules, which the Exchange believes will make the rule regarding permissible exercise prices for FLEX Options more transparent and thus may eliminate potential confusion regarding permissible exercise prices.¹³

- The proposed rule change moves the parenthetical regarding the System rounding the exercise price to the nearest minimum increment for bids and offers in the class (as set forth in Rule 5.4) from the introductory clause in Rule 4.21(b)(6) to the end of subclause (A)(ii), and makes corresponding changes to Rules 5.3(e)(3) and 5.4(c)(4) by enclosing that language in a parenthetical so that it applies only to subclause (B) of each subparagraph. While not specified in the Rules, such rounding would only occur for exercise prices and bids and offers (as discussed below, the proposed rule change replaces “bids and offers” with “transaction prices”), respectively, expressed as a percentage, so the proposed rule clarifies that it applies only for exercise prices and bids and offers, respectively, expressed as a percentage and specifies that the System rounds the actual exercise prices and final

¹³ The Exchange believes this flexibility is appropriate to permit the Exchange to make determinations based on the market characteristics of different classes. The Exchange notes the rules of another options exchange similarly permit that exchange to determine on a class-by-class basis both minimum increments for exercise prices and premiums (i.e., bids and offers) stated using a percentage-based methodology. See, e.g., NYSE Arca, Inc. (“Arca”) Rule 5.32-O(e)(2)(C).

transaction prices,¹⁴ respectively, to the nearest fixed price minimum increment for bids and offers in the class.

The proposed rule change also adds to the parenthetical in Rule 4.21(b)(6)(A)(ii) that the System rounds the “actual” exercise price to the nearest fixed price minimum increment to provide additional clarity to the provision, as the dollar value of an exercise price expressed as a percentage determined after the closing value is available would be rounded to the nearest minimum dollar value increment, which dollar value would represent the ultimate, “actual” exercise price.¹⁵ Similarly, the proposed rule change adds to the proposed parentheticals in Rules 5.3(e)(3)(B) and 5.4(c)(4)(B) that the System rounds the “final transaction prices” to the fixed price minimum increment to the class, as the dollar value of the transaction price of a FLEX Option for which the bids and offers were expressed as a percentage (the “final”) determined after the closing value is available would be rounded to the nearest fixed price minimum increment for the class (e.g., the nearest \$0.01, if that is the minimum determined for the class). This is the same rounding process that applies today for these options. The Exchange notes current Rules 5.3(e)(3)(B) and 5.4(c)(4)(B) indicate the System rounds bids and offers to the nearest minimum increment. However, because bids and offers during a FLEX Auction are ranked based on the percentage amounts of bids and offers (as discussed below), and thus the transaction price(s) at the conclusion of the auction will be a percentage amount, there will no longer be bids and offers to round once the closing value of the underlying on the trade date is available. Rather, the transaction price is

¹⁴ Amendment No. 1 replaces the phrase “bids and offers” in this sentence with “transaction prices” to reflect the updated term in the rule text.

¹⁵ As discussed above, the dollar value minimum increment for bids and offers is either \$0.001 (for FLEX Orders submitted into electronic FLEX Auctions) (as proposed) or \$0.01 (for FLEX Orders submitted into open outcry FLEX Auctions).

rounded. The proposed rule change corrects this term in these parentheses to more accurately reflect how the System currently works.

Currently, as clarified by these proposed rule changes (and the additional description regarding rankings of bids and offers in FLEX Auction, as discussed below), bids and offers expressed as a percentage of the closing value of the underlying on the trade date are ranked by the percentage amount for FLEX Option series for which the exercise price is expressed as such a percentage. As a result, the transaction “price(s)” at the conclusion of a FLEX Auction will be a percentage amount(s). Once the closing value of the underlying on the trade date is available, the System determines the exercise price and transaction price in a dollar amount using that closing value, and rounds each to the minimum dollar amount increment at that time. For example, suppose a FLEX Trader submits an order to buy 100 contracts of FLEX Option series ABC Mar 50.24% into a FLEX Auction. There are two responses, each to sell 100, with response 1 offering to sell at 7.01% and response 2 to sell at 7.03%. Response 1 is a better price for the buy order (i.e. is ranked higher than response 2), so response 1 executes against the buy order at the conclusion of the auction for a transaction price of 7.01% of the closing value of the underlying on that date. Following the close of trading, the closing price of ABC on the day of that trade is \$47.63. At that time, the System determines the actual exercise price in dollars to be \$23.93 (rounded from 23.929).¹⁶ At that time, the System also determines the final transaction price in dollars to

¹⁶ This Amendment No. 1 corrects a typo in the parenthetical in this sentence by updating “23.939” to “23.929” to reflect the actual calculated exercise price, which rounds to \$23.93. Additionally, Amendment No. 1 adds the following sentence in this footnote to describe how the actual exercise price is calculated. Specifically, as set forth in Rule 4.21(b)(6), a FLEX Option series with a percentage exercise price reflects a percentage of the closing value of the underlying equity security or index, as applicable, on the trade date. Therefore, in this example, the actual exercise price is the percentage (50.24%) of

be \$3.34 (rounded from 3.338).¹⁷ The System currently works this way and will continue to work in this way upon implementation of the proposed rule change (if approved), except rounding will occur to three decimals instead of two for electronic FLEX Orders.

- In addition, the proposed rule change makes a clarifying, nonsubstantive change to Rule 5.3(e)(3). Rule 5.3(e)(3) currently states that bids and offers for FLEX Options must be expressed in (a) U.S. dollars and decimals, if the exercise price for the FLEX Option series is a fixed price, or (b) a percentage, if the exercise price for the FLEX Option series is a percentage of the closing value of the underlying equity security or index on the trade date, per unit of the underlying security or index, as applicable. The System rounds bids and offers to the nearest minimum increment. The proposed rule change clarifies in the proposed parenthetical in Rule 5.3(e)(3)(B) (described in the preceding bulleted paragraphs) that bids and offers would be in the applicable minimum increment as set forth in Rule 5.4. This is true today and merely incorporates a cross-reference to Rule 5.4, which describes permissible minimum increments for bids and offers. The Exchange believes the addition of this cross-reference will provide additional transparency and clarity to this Rule.

The proposed rule change also codifies in Rules 5.72(c)(3)(A) and (d)(2), 5.73(e), and 5.74(e) how FLEX Auction response bids and offers (as well as Initiating Orders and Solicitation Orders with respect to FLEX AIM Auctions and FLEX SAM Auctions, respectively) are ranked

the closing value of underlying ABC on the trade date (\$47.63), which is 23.929, which the System rounds to \$23.93. Contract multipliers are applied after any rounding occurs.

¹⁷ This Amendment No. 1 adds this footnote to describe how the actual transaction price is calculated. Specifically, as set forth in Rule 5.4(c)(4), a FLEX Option series with a percentage bid or offer reflects a percentage of the closing value of the underlying equity security or index, as applicable, on the trade date. Therefore, in this example, the actual transaction price is the percentage (7.01%) of the closing value of underlying ABC on the trade date (\$47.63), which is 3.338, which the System rounds to \$3.34.

during the allocation process following each type of FLEX Auction (*i.e.*, electronic FLEX Auction, open outcry FLEX Auction, FLEX AIM Auction, and FLEX SAM Auction, respectively). FLEX Orders will always first be allocated to responses at the best price, as applicable.¹⁸ With respect to responses to all types of FLEX Auctions for a FLEX Option series with an exercise price expressed as a dollar and decimal, the “prices” at which FLEX Traders submitting responses are competing are the dollar and decimal amounts of the response bids and offers entered as fixed amounts (as is the case with all non-FLEX Options), and the proposed rule change codifies this in the Rules. With respect to responses to all types of FLEX Auctions for a FLEX Option series with an exercise price expressed as a percentage, the “prices” at which FLEX Traders submitting responses are competing are the percentage values of the response bids and offers entered as percentages (which ultimately become a dollar value after the closing value for the underlying security or index, as applicable, is available), and the proposed rule change codifies this in the Rules. These are nonsubstantive changes, as they reflect how ranking following FLEX Auctions occurs today, and the Exchange believes these changes will provide additional transparency in the Rules.

The Exchange notes that responses to the Exchange’s electronic FLEX Auctions are not visible to other FLEX Traders, and therefore FLEX Traders will not be able to compete by increasing or decreasing bids and offers, respectively, of other FLEX Traders by a minute increment.¹⁹ The Exchange does not currently propose to add more precision for bids and offers and exercise prices for open outcry FLEX Auctions to avoid the risk of such competition because

¹⁸ The proposed rule change also clarifies this in Rule 5.72(d)(2) by adding a cross-reference to Rule 5.85(a)(1), which states that, with respect to open outcry trading on the Exchange’s trading floor, bids and offers with the highest bid and lowest offer have priority. This is a nonsubstantive change that is currently true for open outcry FLEX Auctions, and the proposed rule change merely makes this explicit in Rule 5.72(d)(2), which cross-reference was previously inadvertently omitted from the Rules.

¹⁹ See Rules 5.72(c)(2)(D)(iv), 5.73(c)(5)(E), and 5.74(c)(5)(E).

FLEX Traders in the trading crowd can hear the responses of others in the crowd. The Exchange understands that demand for the additional precision is primarily for electronic trading.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Securities Exchange Act of 1934 (the “Act”) and the rules and regulations thereunder applicable to the Exchange and, in particular, the requirements of Section 6(b) of the Act.²⁰ Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)²¹ 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)²² requirement that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

In particular, the Exchange believes the proposed rule change will protect investors and the public interest by providing investors with the ability to obtain more precise premiums and exercise prices for FLEX Options in electronic FLEX trading. Given the various trading and hedging strategies employed by investors and the importance of every penny, particularly with larger orders and orders in classes with significant notional values, this additional precision may

²⁰ 15 U.S.C. 78f(b).

²¹ 15 U.S.C. 78f(b)(5).

²² Id.

provide them with more control over the prices at which their FLEX Orders trade and are exercised. The total price of an order for 10,000 contracts of a series will be much greater than (i.e., 100 times) the total price of an order for 100 contracts of the same series, and therefore additional precision may impact that price. For example, suppose a FLEX Trader buys 1 ABC Mar 20 at 1.05%, and the closing price of ABC on the day of that trade is \$50, making the final purchase price \$0.53 (rounded from 0.525),²³ for a total of \$53 after applying the 100 contract multiplier. Suppose another FLEX Trader buys 10,000 of the same series at the same price, making the total purchase price \$530,000. With the proposed rule change, suppose each FLEX Trader instead paid 1.0455% (which decimal is currently not permissible and would have needed to be input as 1.05%), for a purchase price of \$0.523 (rounded from 0.52275).²⁴ The total purchase price of the first trade would be \$52.30 (down from \$53), and the total purchase price of the second trade would be \$523,000 (down from \$530,000). The additional precision for the smaller order permitted the FLEX Trader to pay \$0.70 less, while the additional precision for the larger order permitted the FLEX Trader to pay \$7,000 less. This example demonstrates how the impact on larger-sized orders may be particularly significant given the larger total purchase price. The larger impact is similar for options with larger notional values. While additional decimals may be available for bids and offers and exercise prices for FLEX Options submitted into electronic auctions pursuant to the proposed rule change, FLEX options will otherwise continue to trade in the same manner as they do today.

²³ As described in the prior example above, any rounding of the final transaction price to the minimum fixed increment occurs following the close of trading on the trade date once the closing value of the underlying on that date is available, after the percentage of the underlying closing value is calculated.

²⁴ Id.

By permitting FLEX Options to trade with similar precision currently available to customized options in the OTC market, the Exchange believes the proposed rule change will remove impediments to and perfect the mechanism of a free and open market and a national market system by further improving a comparable alternative to the OTC market in customized options. By enhancing our FLEX trading platform to provide additional terms available in the OTC market but not currently available in the listed options market, the Exchange believes it may be a more attractive alternative to the OTC market. The Exchange believes market participants benefit from being able to trade customized options in an exchange environment in several ways, including but not limited to the following: (1) enhanced efficiency in initiating and closing out positions; (2) increased market transparency; and (3) heightened contra-party creditworthiness due to the role of The Options Clearing Corporation (“OCC”) as issuer and guarantor of FLEX Options.

The Exchange does not believe that the proposed rule change to permit FLEX Traders to submit bids and offers in a “sub-increment” as small as \$0.001 or 0.0001% (which bids and offers would be ranked for allocation purposes based on that four-decimal percentage value) as opposed to the current minimum of \$0.01 or 0.01% for electronic FLEX auctions raises any of the risks the Securities and Exchange Commission (the “Commission”) has previously raised with respect to “sub-increment” pricing. In its reproposal of the “Sub-Penny Rule,”²⁵ the Commission stated that

²⁵ The “Sub-Penny Rule” in Rule 612 of Regulation NMS states that no national securities exchange, national securities association, alternative trading system, vendor, or broker or dealer may display, rank, or accept from any person a bid or offer, an order, or an indication of interest in any NMS stock priced in an increment smaller than \$0.01 if that bid or offer, order, or indication of interest is priced equal to or greater than \$1.00 per share. The minimum increment for a bid or offer, an order, or an indication of interest in any NMS stock priced less than \$1.00 per share is \$0.0001. See 17 CFR § 242.612. While Rule 612 applies only to NMS stocks and not options, no options exchange permits bids or offers on options to be less than \$0.01.

“sub-penny quoting impedes transparency by reducing market depth at the national best bid or offer (“NBBO”) and increasing quote flickering.”²⁶ The Commission stated in its overview of the proposed Sub-Penny Rule that the rule “would address the practice of ‘stepping ahead’ of *displayed* limited orders by trivial amounts” and therefore “further encourage the display of limit orders and improve the depth and liquidity of trading in NMS stocks.”²⁷ Specifically, the Commission identified the following problems caused by sub-pennies that the Sub-Penny Rule was designed to address when approving the Sub-Penny Rule:

- If investors’ limit orders lose execution priority for a nominal amount, investors may over time decline to use them, thus depriving the markets of liquidity.
- When market participants can gain execution priority for a nominal amount, important customer protection rules such as exchange priority rules and the Manning Rule could be undermined.
- Flickering quotations that can result from widespread sub-penny pricing could make it more difficult for broker-dealers to satisfy their best execution obligations and other regulatory responsibilities.
- Widespread sub-penny quoting could decrease market depth and lead to higher transaction costs.

²⁶ See Securities Exchange Act Release No. 50870, 69 FR 77423, 77484 (December 27, 2004) (proposed rules and amendments to joint industry plans).

²⁷ Id. at 77429 (emphasis added).

- Decreasing depth at the inside could cause institutions to rely more on execution alternatives away from the exchanges, potentially increasing fragmentation in the securities markets.²⁸

The Commission, however, “acknowledge[d] the possibility that the balance of costs and benefits could shift in a limited number of cases or as the markets continue to evolve.”²⁹ While the Sub-Penny Rule is inapplicable to options trading, the Exchange understands the same concerns described above may exist in the options markets with respect to subincrement prices.

In the context of FLEX Option trading, there is no NBBO, as execution prices of FLEX Options are not required to consider the prices of options on other exchanges (thus there is no NBBO for FLEX Options). Additionally, there is no book for FLEX Options on the Exchange. As a result, there is no displayed liquidity (or market depth) in front of which interest may “step ahead,” and the concept of quote flickering would not arise in the Exchange’s FLEX Options market. Additionally, the FLEX market is generally less liquid than the non-FLEX market. Trading in FLEX Options may be spread over a larger number of series than non-FLEX Options (due to FLEX options not being pre-established). As a result, trading interest in a particular series of FLEX Options may be limited, making markets in FLEX Options potentially less deep and liquid than in non-FLEX Options with the same underlying interest.³⁰ As a result, the Exchange does not believe the risk that sub-increment trading will lead to reduced market depth and liquidity in the FLEX market, as those may occur due to the nature of the FLEX market in general regardless of the pricing precision available. In fact, as discussed, the Exchange believes the proposed rule change to

²⁸ See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37551 – 52 (June 29, 2005) (“Sub-Penny Approval”).

²⁹ Id. at 37553.

³⁰ See Options Disclosure Document (“ODD”) at pages 77 – 78.

permit additional pricing precision for FLEX Options may provide market participants with additional flexibility to achieve their investment objectives on a listed exchange. These increased investment opportunities may ultimately add liquidity to the FLEX Options market.

Additionally, the Commission made clear that the prohibition of sub-penny quoting would “deter the practice of stepping ahead of *exposed* trading interest by an economically insignificant amount.”³¹ No such practice is possible given that trading interest in FLEX Auctions is not exposed. FLEX Options submitted for electronic execution may only execute pursuant to an electronic auction in which the trading interest of competing FLEX Traders is not exposed as set forth in Rules 5.72, 5.73, and 5.74. As noted above, responses to the Exchange’s electronic FLEX Auctions are not visible to other FLEX Traders.³² Therefore, there will generally be no displayed liquidity to which other FLEX Traders may respond by purposefully increasing or decreasing their bids and offers, respectively, of other FLEX Traders by a trivial amount. Unlike limit orders, auction responses are not intended to serve a price-setting function. Therefore, the Exchange does not believe that the proposed “sub-increment” for electronic FLEX Auctions will diminish liquidity in these auctions as the Commission believes sub-penny quoting may cause with respect to displayed limit orders that do serve a price-setting function in the displayed market.³³ As discussed above, the purpose of FLEX Options is to add transparency to the market by encouraging the trading of customized options on the Exchange rather than in OTC. As noted above, trading in FLEX Options may be spread over a larger number of series than non-FLEX Options (due to FLEX

³¹ See Securities Exchange Act Release No. 50870, 69 FR 77423, 77457 (December 27, 2004) (proposed rules and amendments to joint industry plans) (emphasis added).

³² The Exchange does not disseminate the auction prices for any FLEX Auctions (except the FLEX SAM Auction). See Rules 5.72(c)(2)(A) and 5.73(c)(2); see also 5.74(c)(2).

³³ See supra note 24 [sic] at 77457.

options not being pre-established). As a result, trading interest in a particular series of FLEX Options may be limited, making markets in FLEX Options potentially less deep and liquid than in non-FLEX Options with the same underlying interest.³⁴ The Exchange believes the proposed enhancement to FLEX trading in this rule filing may encourage additional Exchange trading and liquidity in these options, which benefits all investors.

While it is possible that the ultimate result is that a FLEX Trader's response in an electronic FLEX Auction may lose execution priority if the response of another FLEX Trader is better by a small amount, it is just as possible the FLEX Trader may gain execution priority by a small amount. Because a FLEX Trader would not know the prices of other responses, the FLEX Trader could not submit a response with the purpose of increasing the prices of other responses by an economically insignificant amount. The purpose of not displaying auction responses of other auction participants is to encourage all FLEX Traders to submit their best-priced responses.³⁵ As demonstrated above, even small price changes can create a significant price difference. The Exchange does not believe the proposed rule change will discourage FLEX Traders from providing liquidity to electronic FLEX Auctions, because the prices of their responses are not available to other FLEX Traders to use to step ahead by a small amount (and thus "piggyback" off of pricing done by other investors) in order to gain execution priority. The Commission itself acknowledged the difference between use of a sub-increment in the context of an auction and in the context of displayed liquidity in the book. Specifically, in response to a commenter arguing that the Commission should prohibit the Boston Options Exchange ("BOX") from using "sub-increment" pricing in its price improvement period ("PIP") auction,³⁶ the Commission states that it did "not believe that the PIP raise[d] the same

³⁴ See Options Disclosure Document ("ODD") at pages 77 – 78.

³⁵ FLEX Traders are permitted to submit multiple responses at multiple prices).

³⁶ BOX was permitting penny increments in this price improvement auction despite the

problems caused by sub-penny quotations of non-option securities . . .” because the use of the sub-increment was in an auction rather than public quotations.³⁷

While equities and options may generally not trade in increments smaller than \$0.01,³⁸ there are exceptions to this restriction for specific, limited purposes. As noted above, the minimum increment for a bid or offer, an order, or an indication of interest in any NMS stock priced less than \$1.00 per share is \$0.0001.³⁹ Sub-penny cabinet orders may execute on the Exchange to accommodate closing transactions in options.⁴⁰ In both cases, sub-increment pricing permits more appropriate prices to apply to lower-valued stocks and options.

In addition, various equity exchanges offer retail price improvement programs, pursuant to which retail orders may be entered in increments of \$0.001 if the prices of those retail orders increase the NBBO at the time of entry (the prices of the orders would be nondisplayed), despite the \$0.01 minimum increment for all other orders.⁴¹ While the purpose of these retail price

standard increments for options being \$0.05 and \$0.10. See Securities Exchange Act Release No. 49068 (January 13, 2004), 69 FR 2775 (January 13, 2004) (SR-BSE-2002-15) (order approving PIP auctions that permit orders and responses be submitted into the auctions in penny increments).

³⁷ See supra note 24 [sic] at 77459. The Exchange acknowledges that it submitted the comment arguing for prohibition of the use of sub-increment pricing in BOX’s PIP auction. However, the Commission approved it as being consistent with the Exchange Act (and the Exchange itself has similar price improvement auctions that permit penny pricing in options with minimum increments of \$0.05 and \$0.10), and the Commission disagreed with the Exchange’s argument.

³⁸ As set forth in Rule 5.4, some options classes may trade in increments of \$0.01 or \$0.05 (several classes may trade in increments of \$0.01 for all strikes), while other classes may trade in increments of \$0.05 or \$0.10. Complex orders may generally trade in increments of \$0.01, and FLEX class may trade in increments of \$0.01 or 0.01%.

³⁹ See 17 CFR § 242.612.

⁴⁰ See Rule 5.85(h).

⁴¹ See, e.g., Cboe BYX Exchange, Inc. (“BYX”) Rule 11.24. The Exchange notes that multiple retail orders will be ranked for priority purposes based on their prices (including any subpenny prices).

improvement programs was to create additional price improvement opportunities for retail investors,⁴² the impetus for the programs was similar to the purpose of the proposed rule change. Specifically, the Commission recognized that most marketable retail order flow executed in OTC markets without reaching a public exchange, therefore limiting market participants that had the opportunity to interact with that order flow.⁴³ The Commission indicated it believed creating additional price improvement opportunities for retail investors by permitting those orders to be submitted at subpenny prices (as was typical in the OTC market), the program was “reasonably designed to attract retail order flow to the exchange environment.”⁴⁴ The Commission also noted the benefits to institutional investors that may result from opportunities to interact with that order flow that such investors were not then able to reach in the OTC market.⁴⁵ Ultimately, the Commission found the Program would benefit the marketplace by bringing more information about retail orders to the marketplace and would enhance competition among market participants and encourage competition amongst exchange venues.⁴⁶

⁴² It is common for markets to generally distinguish between retail investors and other traders; however, it is also common for markets to generally distinguish between FLEX trading and non-FLEX trading. For example, as otherwise discussed in this filing, the manner in which FLEX Options trades (via auction only) differs from the manner in which non-FLEX options trade (a combination of a book into which orders may be submitted as well as auctions). Additionally, as noted above, all FLEX Options may trade in pennies, while only certain non-FLEX Options (with certain strikes) may trade in pennies.

⁴³ See Securities Exchange Act Release No. 68303 (November 27, 2012), 77 FR 71652, 71655 (December 3, 2012) (SR-BYX-2012-019) (“BYX Approval Order”). The BYX retail price improvement program was initially approved as a pilot program; however, the Commission later approved it to become a permanent program. See Securities Exchange Act Release No. 87154 (September 30, 2019), 84 FR 53183 (October 4, 2019) (SR-CboeBYX-2019-014).

⁴⁴ Id. at 71656.

⁴⁵ Id.

⁴⁶ Id. at 71657.

Like the BYX retail price improvement program (and other similar programs), the proposed rule change is intended to attract order flow that currently executes in the OTC market to an exchange by permitting competition on the exchange for that order flow to occur with the same terms available in the OTC market. FLEX Traders on the Exchange are not currently able to interact with order flow for many options that could otherwise trade as FLEX Options because it is routinely executed in the OTC market where sub-increment executions are available so they can obtain the benefits of pricing precision as described above. The Exchange believes the proposed rule change is reasonably designed, limited to FLEX Options (which represents a small percentage of Exchange volume), to attract FLEX Option order flow to the Exchange, which would add transparency to the market for these options, as well as provide those options with the benefits of trading on an exchange (which benefits are described above).

Like the retail price improvement programs, the Exchange believes the proposed rule change is a case in which the benefits of subincrement pricing due to evolving markets outweigh any potential costs. The benefits of attracting FLEX Option order flow to an exchange are outlined above. Exchanges are unable to currently compete to equal footing with the OTC market for a variety of factors, including due to the current lack of availability of subincrement pricing. The proposed rule change is a limited exception to the current minimum of penny increment pricing on the Exchange, which is reasonably designed to minimize the concerns the Commission has previously raised with respect to subincrement pricing. Because there is no book, and thus no quotes or resting limit orders, in the FLEX Options market, the Exchange believes there is de minimis, if any, risk of reducing incentives for investors to display limit orders or for quote-flickering and reduced market depth. In fact, by attracting more FLEX Option order flow to the Exchange, the Exchange believes the proposed rule change could result

in greater order interaction and liquidity in the FLEX Options market. As noted above, because all FLEX Options may only execute in auctions in which responses are not disseminated, the Exchange believes the proposed rule change does not encourage market participants to step ahead of competing responses to gain an insignificant price improvement because those prices are not displayed. The proposed rule change is designed to attract order flow away from the alternative of OTC execution, and, therefore, the Exchange does not believe the proposed rule change will cause increased fragmentation (and in fact it may reduce this fragmentation).

Because the proposed rule change is limited to FLEX Options and given the structure of the FLEX market on the Exchange, the Exchange believes the benefits of increasing the potential to compete with OTC markets for FLEX orders in order to bring additional transparency to executions occurring off-exchange today and to provide those orders with the benefits of trading on an exchange far outweigh any risks related to subincrement pricing that may exist in the FLEX Options market (which, as described above, the Exchange believes are minimal). As a result, the Exchange believes the proposed rule change will benefit investors and remove impediments to and perfect the mechanism of a free and open market and a national market system, as well as promote just and equitable principles of trade and promote competition by permitting the Exchange to compete on similar terms with the OTC market.

The Exchange believes the proposed rule change to describe how bids and offers in FLEX Auctions for FLEX Option series are ranked and allocated will remove impediments to and perfect the mechanism of a free and open market and a national market system and protect investors and the public interest by increasing the transparency in the Rules regarding the allocation of FLEX Orders at the conclusion of FLEX Auctions. The proposed rule change codifies that the term “price” in the rules regarding allocations following FLEX Auctions refers

to the dollar and decimal amount of bids and offers submitted as a fixed amount (as is the case for all non-FLEX Options and which as proposed may be as small as \$0.001 for FLEX Options), and the percentage value (which as proposed may be as small as 0.0001%) of bids and offers submitted as percentages. As percentages ultimately reflect a price in dollars and cents, and thus allocation of a FLEX Order to the highest percentage bids and lowest percentage offers still results in allocation of that order to the best prices in the same manner as bids and offers in dollars and cents. For example, a bid of 1.05% will be for a higher dollar value than a bid of 1.04%, because a higher percentage of a number will have a higher value than a lower percentage of that same number. This is a reasonable allocation that ensures highest priced bids and offers receive first priority (and is the same as how dollar-priced bids and offers are ranked), which protects investors.

The Exchange believes the proposed nonsubstantive changes, codification of a longstanding interpretation, and correction of terms described above enhance the readability of and provide clarity to the applicable provisions, which increases the transparency of the Rules and ultimately benefits investors.

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

The Exchange 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 Exchange does not believe that the proposed rule change to increase precision for bids and offers and exercise prices for electronic FLEX Auctions will impose any burden on intramarket competition that is not necessary or appropriate in furtherance of the purposes of the Act, because the same bid and offer and exercise price increments will be available to all FLEX Traders. While the same precision will not be available in open outcry FLEX Auctions, all FLEX Traders have the ability to submit FLEX Orders for electronic execution if they desire to

trade with additional precision.⁴⁷ The Exchange does not believe that the proposed rule change to increase the precision for bids and offers and exercise prices for FLEX Options submitted for electronic execution will impose any burden on intermarket competition that is not necessary or appropriate in furtherance of the purposes of the Act, because while additional decimals may be available for bids and offers and exercise prices for electronic auctions, FLEX options will continue to trade in the same manner as they do today. While FLEX markets may be less liquid than non-FLEX markets for options with the same underlying, the Exchange believes the proposed rule change may increase liquidity in the FLEX markets. To the extent the proposed rule change makes the Exchange a more attractive trading venue for market participants on other exchanges, those market participants may elect to become Exchange market participants.

The Exchange believes that the proposed rule change may relieve any burden on, or otherwise promote, competition. The Exchange believes this is an enhancement to a comparable alternative to the OTC market in customized options. By enhancing our FLEX trading platform to provide additional pricing terms that are available in the OTC market but not currently available in the listed options market, the Exchange believes it may be a more attractive alternative to the OTC market. The Exchange believes market participants benefit from being able to trade customized options in an exchange environment in several ways, including but not limited to the following: (1) enhanced efficiency in initiating and closing out position; (2) increased market transparency; and (3) heightened contra-party creditworthiness due to the role of OCC as issuer and guarantor of FLEX Options. The Exchange believes these benefits in addition to the benefits of precision pricing described above far outweigh the minimal (if any) risks of sub-increment pricing in the FLEX market.

⁴⁷ Options generally have different minimum increments in the same class. See Rule 5.4.

The nonsubstantive proposed rule changes, as well as the codification of an interpretation and term correction, are not intended for competitive purposes, but rather to increase transparency in the Rules by codifying current System functionality and practice with respect to FLEX Option bids and offers. These changes do not modify how FLEX Options trade on the Exchange and merely provide enhanced clarity and readability to the Rules.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

A. by order approve or disapprove such proposed rule change, or

B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as modified by Amendment No. 1, 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-2020-106 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, D.C. 20549-1090.

All submissions should refer to File Number SR-CBOE-2020-106. 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. 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-2020-106, 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.⁴⁸

J. Matthew DeLesDernier
Assistant Secretary

⁴⁸ 17 CFR 200.30-3(a)(12).