

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-92599; File No. SR-CBOE-2021-041)

August 6, 2021

Self-Regulatory Organizations; Cboe Exchange, Inc.; Notice of Filing of a Proposed Rule Change to Amend Certain Rules to Accommodate the Listing and Trading of Micro FLEX Index Options and to Make Other Clarifying and Nonsubstantive Changes

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 23, 2021, Cboe Exchange, Inc. (the “Exchange” or “Cboe Options”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

Cboe Exchange, Inc. (the “Exchange” or “Cboe Options”) proposes to amend certain Rules to accommodate the listing and trading of Micro FLEX Index Options and to make other clarifying and nonsubstantive changes. The text of the proposed rule change is provided in Exhibit 5.

The text of the proposed rule change is also 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.

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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> On August 4, 2021, the Exchange filed Partial Amendment No. 1 to the proposed rule change. The Exchange withdrew Partial Amendment No. 1 on August 6, 2021.

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 purpose of this proposed rule change is to amend certain rules to accommodate the listing and trading of certain FLEXible EXchange (“FLEX”) index options with an index multiplier of one (“Micro FLEX Index Options”). The Exchange has the authority to list options on broad-based indexes for which the value of the underlying is at least 100 with an index multiplier of one<sup>4</sup> and proposes to expand that authority to list FLEX Index Options on the same indexes with an index multiplier of one. The Exchange believes Micro FLEX Index Options will expand investors’ choices and flexibility by listing and trading FLEX Options on larger-valued broad-based indexes, which provide investors with the ability to gain exposure to the market, with a notional value of 1/100<sup>th</sup> of the value of currently available FLEX Index Options.

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<sup>4</sup> See Rule 4.11 (definition of micro-option). Currently, the Exchange has the authority to list options on 13 indexes that satisfy this criteria: S&P 500 Index, Mini-S&P 500 Index (XSP), Russell 2000 Index (RUT), Mini-Russell 2000 Index (MRUT), Dow Jones Industrial Average (DJX), S&P 100 Index (OEX and XEO), S&P 500 ESG Index (SPESG), MSCI EAFE Index (MXEA), MSCI Emerging Markets Index (MXEF), Russell 1000 Growth Index (RLG), Russell 1000 Value Index (RLV), Russell 1000 Index (RUI), and FTSE 100 Mini-Index (UKXM). The proposed rule change would authorize the Exchange to list Micro FLEX Index Options on the same 13 indexes.

The Exchange believes the additional granularity provided by Micro FLEX Index Options with respect to the prices at which investors may execute and exercise index options on the Exchange will appeal to institutional investors by providing them with an additional exchange-traded tool to manage the positions and associated risk in their portfolios more precisely based on notional value, which currently may equal a fraction of a standard contract. For example, suppose an investor holds a security portfolio of \$10,000,000 and desires to hedge its portfolio with SPX options. In order to hedge the entire portfolio with SPX options, the investor would need to trade 23.11 contracts ( $\$10,000,000/\$432,770$ ).<sup>5</sup> The nearest whole number of contracts would be 23 contracts, which would have a total notional value of \$9,953,710. As a result, the investor could only hedge within \$46,290 of its portfolio value with SPX options with an index multiplier of 100 and would be underhedged. However, with SPX micro-options, the investor would need to trade 2,310.70 contracts ( $\$10,000,000/\$4,327.70$ ). The nearest whole number of contracts would be 2,311 SPX micro-options,<sup>6</sup> which would have a total notional value of \$10,001,314.70. This will allow the investor to hedge within \$1,315 of its portfolio value. Therefore, the proposed rule change would permit this investor to hedge its portfolio more effectively with far greater precision.

The Exchange notes investors may currently execute and exercise options with this smaller contract multiplier in the unregulated over-the-counter (“OTC”) options market. The Exchange understands that investors may prefer to trade such options in a listed environment to receive the benefits of trading listing options, including (1) enhanced efficiency in initiating and

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<sup>5</sup> This assumes an S&P 500 Index value of 4,327.70.

<sup>6</sup> An investor could also trade 23 SPX options and 11 micro-options. We do not, however, expect investors to make two separate trades in this manner due to the additional price and execution risk that accompanies two separate trades compared to a single trade.

closing out position; (2) increased market transparency; and (3) heightened contra-party creditworthiness due to the role of OCC as issuer and guarantor of all listed options. The Exchange believes the proposed rule change may shift liquidity from the OTC market onto the Exchange, which the Exchange believes would increase market transparency as well as enhance the process of price discovery conducted on the Exchange through increased order flow.

Currently, Rule 4.21(b)(1) states the index multiplier for FLEX Index Options is 100. The proposed rule change adds that the index multiplier for FLEX Index Options on broad-based indexes for which the value of the underlying is at least 100<sup>7</sup> may also be one (a “Micro FLEX Index Option”) (in addition to the current index multiplier of 100), and that a FLEX Trader must specify when submitting a FLEX Order.

To the extent the Exchange lists a Micro FLEX Index Option on an index on which it also lists a standard FLEX Index option, it will be listed with a different trading symbol than the standard index option with the same underlying index to reduce any potential confusion.<sup>8</sup> The Exchange believes that the clarity of this approach is appropriate and transparent. The Exchange recognizes the need to differentiate Micro FLEX Index Options from standard FLEX Index Options and believes the proposed rule change will provide the necessary differentiation.

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<sup>7</sup> These are the same indexes on which the Exchange may list micro-options (non-FLEX options with an index multiplier of one).

<sup>8</sup> For example, a standard FLEX Index Option for index ABC with an index multiplier of 100 may have symbol 4ABC, while a Micro FLEX Index Option for index ABC with a multiplier of one may have symbol 4ABC9. Similarly, in the non-FLEX market, a non-FLEX option on index ABC with an index multiplier of 100 may have symbol ABC, while a non-FLEX micro-option would have a different symbol (such as ABC9).

When submitting a FLEX Order, the submitting FLEX Trader<sup>9</sup> must include all required terms of a FLEX Option series.<sup>10</sup> Pursuant to current Rule 4.21(b)(1), the submitting FLEX Trader must include the underlying equity security or index (*i.e.*, the FLEX Option class) on the FLEX Order. The proposed rule change amends Rule 4.21(b)(1) to state that if a FLEX Trader specifies an index on a FLEX Order, the FLEX Trader must also include whether the index option has an index multiplier of 100 or 1 when identifying the class of FLEX Order. The Exchange is specifying it may list FLEX Index Option classes with an index multiplier of either 1 or 100. Therefore, each FLEX Index Option series in a Micro FLEX Index Option class will include the same flexible terms as any other FLEX Option series, including strike price, settlement, expiration date, and exercise style as required by Rule 4.21(b).<sup>11</sup>

FLEX Micro Options will be traded in the same manner as all other FLEX Options pursuant to Chapter 5, Section F of the Rules. There are two important distinctions between FLEX Index Options with a multiplier of 100 and FLEX Micro Options due to the difference in multipliers.

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<sup>9</sup> A “FLEX Trader” is a Trading Permit Holder the Exchange has approved to trade FLEX Options on the Exchange.

<sup>10</sup> These terms include, in addition to the underlying equity security or index, the type of options (put or call), exercise style, expiration date, settlement type, and exercise price. See Rule 4.21(b). A “FLEX Order” is an order submitted in FLEX Options. The submission of a FLEX Order makes the FLEX Option series in that order eligible for trading. See Rule 5.72(b).

<sup>11</sup> As discussed below, these are the terms designated by the Commission as those that constitute standardized options, and therefore, the Exchange believes the proposed rule change is consistent with Section 9(b) of the Act. See Securities Exchange Act Release No. 31910 (February 23, 1993), 58 FR 12056 (March 2, 1993) (“1993 FLEX Approval Order”).

Term	Index Multiplier of 100)	Index Multiplier of 1)
Strike Price	4330	4330
Bid or offer	32.05	32.05
Total Value of Deliverable	\$433,000	\$4,330
Total Value of Contract	\$3,205	\$32.05

The proposed rule change amends certain Rules describing the exercise prices and bids and offers of FLEX Options to reflect these distinctions (as further described below).

The Rules permit trading in a put or call FLEX Option series only if it does not have the same exercise style, same expiration date, and same exercise price as a non-FLEX Option series on the same underlying security or index that is already available for trading.<sup>12</sup> In other words, a FLEX Option series may not have identical terms as a non-FLEX Option series listed for trading. The proposed rule change adds to the introductory paragraph of Rule 4.21(b) that a FLEX Index Option with an index multiplier of one may not be the same type (put or call) and may not have the same exercise style, expiration date, settlement type, and exercise price as a non-FLEX Index Option overlying the same index listed for trading (regardless of the index multiplier of the non-FLEX Index Option) (i.e., a Micro FLEX Index Option may not have the same terms as a non-FLEX Index Option or non-FLEX micro-option). This will prevent a Micro FLEX Index Option from being listed with terms identical to those of a non-FLEX Index Option (with an index multiplier of 1 or 100) on the same index.

Pursuant to Rule 4.22(a), a FLEX Option position becomes fungible with a non-FLEX option that becomes listed with identical terms. As discussed above, options with different multipliers are different classes, and an option series in one class cannot be fungible with an option series in another classes, even if they are economically equivalent. Fungibility is only

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<sup>12</sup> See Rule 4.21(a)(1).

possible for series with identical terms. This is similar to how a FLEX XSP Index Option series is not fungible with an economically equivalent non-FLEX SPX Option series. Therefore, a FLEX Micro Option would become fungible with a non-FLEX micro-option with the same terms pursuant to Rule 4.22(a), but would not be fungible with a non-FLEX option overlying the same index with a multiplier of 100 with the same expiration date, settlement, and exercise price. Because the proposed rule change will not permit a Micro FLEX Index Option to be listed with the same terms as a non-FLEX Index Option regardless of the index multiplier, proposed Rule 4.22(b)(2) states if a non-FLEX Index Option series with an index multiplier of 100 and the same terms as a FLEX Index Option overlying the same index with a multiplier of one is listed for trading, a position established under the FLEX trading procedures may be closed using the FLEX trading procedures in Chapter 5, Section F against another closing only FLEX position during the time period that non-FLEX Index Option series is listed for trading. No FLEX Orders may be submitted into an electronic auction or represented for open outcry trading pursuant to Rule 5.72 for a FLEX Index Option series with a multiplier of one with the same terms as the non-FLEX Index Option series overlying the same index with an index multiplier of 100, unless the FLEX Order is a closing order, during the time that non-FLEX Index Option series is listed for trading.<sup>13</sup> This proposed “closing only” process is similar to the current “closing only” process for non-FLEX Option American-style series added intraday, as set forth in current Rule 4.22(b) (which the Exchange proposes to number as Rule 4.22(b)(1), accompanied by nonsubstantive punctuation mark changes to reflect proposed Rule 4.22(b)(2)). This provision

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<sup>13</sup> To the extent the non-FLEX Index Option is later delisted, then opening trades of the Micro FLEX Index Option may resume after that occurs.

will prevent new Micro FLEX Index Option positions from being opened when a non-FLEX Index Option with a multiplier of 100 with the same terms is listed for trading.<sup>14</sup>

#### Trading Hours

Pursuant to Rule 5.1(b)(3)(A) and (c)(1), Micro FLEX Index Options will be available for trading during the same hours as non-FLEX Index Options pursuant to Rule 5.1(b)(2). Therefore, Regular Trading Hours for Micro FLEX Index Options will generally be 9:30 a.m. to 4:15 p.m. Eastern time.<sup>15</sup> To the extent an index option is authorized for trading during Global Trading Hours, the Exchange may also list Micro FLEX Index Options during that trading session as well, the hours for which trading session are 3:00 a.m. to 9:15 a.m. Eastern time.

#### Expiration, Settlement, and Exercise Style

In accordance with Rule 4.21(b), FLEX Traders may designate the type (put or call), exercise style, expiration date, and settlement type of Micro FLEX Index Options.

#### Exercise Prices

The proposed rule change amends Rule 4.21(b)(6) to describe the difference between the meaning of the exercise price of a FLEX Index Option with a multiplier of 100 and a Micro FLEX Index Option. Specifically, the proposed rule change states that the exercise price for a FLEX Index Option series in a class with a multiplier of one is set at the same level as the exercise price for a FLEX Index Option series in a class with a multiplier of 100.

The proposed rule change also adds the following examples to Rule 4.21(b)(6) regarding how the deliverable for a Micro FLEX Index Option will be calculated (as well as for a FLEX

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<sup>14</sup> If the Exchange lists a non-FLEX Index Option with a multiplier of one with identical terms as a Micro FLEX Index Option, then current Rule 4.22(a) applies to the fungibility of those options (or proposed Rule 4.22(b)(1) if it is an American-style) series added intraday).

<sup>15</sup> Certain indexes close trading at 4:00 p.m. Eastern time. See Rule 5.1.

Index Option with a multiplier of 100 and a FLEX Equity Option, for additional clarity and transparency): If the exercise price of a FLEX Option series is a fixed price of 50, it will deliver: (A) 100 shares of the underlying security at \$50 (with a total deliverable of \$5,000) if a FLEX Equity Option; (B) cash equal to 100 (i.e. the index multiplier) times 50 (with a total deliverable value of \$5,000) if a FLEX Index Option with a multiplier of 100; and (C) cash equal to 1 (i.e. the index multiplier) times 50 (with a total deliverable value of \$50) if a Micro FLEX Index Option. If the exercise price of a FLEX Option series is 50% of the closing value of the underlying security or index, as applicable, on the trade date, it will deliver: (A) 100 shares of the underlying security at a price equal to 50% of the closing value of the underlying security on the trade date (with a total deliverable of 100 times that percentage amount) if a FLEX Equity Option; (B) cash equal to 100 (i.e., the index multiplier) times a value equal to 50% of the closing value of the underlying index on the trade date (with a total deliverable of 100 times that percentage amount) if a FLEX Index Option with a multiplier of 100; and (C) cash equal to 1 (i.e., the index multiplier) times a value equal to 50% of the closing value of the underlying index on the trade date (with a total deliverable of one times that percentage amount) if a Micro FLEX Index Option.

The descriptions of exercise prices for FLEX Equity Options and FLEX Index Options with a multiplier of 100 are true today. The proposed rule change merely adds for purposes of clarity examples to the rule regarding the exercise price of a FLEX Equity Option or a FLEX Index Option with a multiplier of 100 (the deliverables for which are equal to the exercise price times the 100 contract multiplier to determine the deliverable dollar value). Because a Micro FLEX Index Option has a multiplier of 1/100 of the multiplier of a FLEX Index Option with a

multiplier of 100, the value of the deliverable of a FLEX Micro Option as a result is 1/100 of the value of the deliverable of a FLEX Index Option with a deliverable of 100.

### Bids and Offers

Pursuant to Rule 5.4(c), the Exchange will determine the minimum increment for bids and offers on Micro FLEX Index Options (as it does for all other FLEX Options) on a class-by-class basis, which may not be smaller than (1) \$0.01, if the exercise price for the FLEX Option series is a fixed price, or (2) 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.<sup>16</sup> The proposed rule change amends Rule 5.3(e)(3) to describe the difference between the expression of bids and offers for FLEX Equity Options, FLEX Index Options with a multiplier of 100, and Micro FLEX Index Options. Currently, that rule 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.<sup>17</sup> As noted above, a FLEX Option contract unit consists of 100 shares of the underlying security or 100 times the value of the underlying index, as they currently have a 100 contract multiplier.<sup>18</sup> The proposed rule change clarifies that bids and offers are expressed per

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<sup>16</sup> The System rounds bids and offers to the nearest minimum increment.

<sup>17</sup> The proposed rule change reorganizes the language in this provision to make clear that the phrase “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” applies to the entire clause (B) of 5.3(e)(3). The proposed rule change also adds a cross-reference to Rule 5.4 to provide that bids and offers in U.S. dollars and decimals and percentages of the closing values of the underlying equity security or index on the trade date must be in the applicable minimum increment as set forth in Rule 5.4.

<sup>18</sup> See current Rule 4.21(b)(1).

unit, if a FLEX Equity Option or a FLEX Index Option with a multiplier of 100, and adds an example (as set forth below). This is true today, and merely adds clarity to the Rules.

The proposed rule change adds to Rule 5.3(e)(3) a description of the expression of bids and offers for Micro FLEX Index Options. Specifically, bids and offers for Micro FLEX Index 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 per 1/100<sup>th</sup> unit of the underlying security or index, as applicable, 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. Additionally, the proposed rule change adds examples describing the expression of bids and offers of FLEX Options: If the exercise price of a FLEX Option series is a fixed price, a bid of “0.50” represents a bid of (A) \$50 (0.50 times 100 shares) for a FLEX Equity Option; (B) \$50 (0.50 times an index multiplier of 100) for a FLEX Index Option with a multiplier of 100; and (C) \$0.50 (0.50 times an index multiplier of one) for a Micro FLEX Index Option. If the exercise price of a FLEX Option series is a percentage of the closing value of the underlying equity security, a bid of “0.50” represents a bid of (A) 50% (0.50 times 100 shares) of the closing value of the underlying equity security on the trade date if a FLEX Equity Option; (B) 50% (0.50 times an index multiplier of 100) of the closing value of the underlying index on the trade date if a FLEX Index Option with a multiplier of 100; and (C) 0.50% (0.50 times an index multiplier of one) of the closing value of the underlying index on the trade date if a Micro FLEX Index Option. The Exchange believes this approach identifies a clear, transparent description of the differences between FLEX Index Options with a multiplier of 100 and Micro FLEX Index Options. The proposed rule change also provides additional clarity regarding how bids and offers of FLEX Equity Options and FLEX Index Options with a multiplier of 100 are expressed.

## Contract Size Limits

The proposed rule change updates various other provisions in the following Rules to reflect that one-hundred micro-contracts overlying an index will be economically equivalent to one contract for a standard index option overlying the same index:

- Rule 5.74: Rule 5.74 describes the Exchange's FLEX Solicitation Auction Mechanism ("FLEX SAM"). An order, or the smallest leg of a complex order, must be for at least the minimum size designated by the Exchange (which may not be less than 500 standard option contracts or 5,000 mini-option contracts). The proposed rule change adds that 50,000 Micro FLEX Index Options is the corresponding minimum size for orders submitted into FLEX SAM Auctions.
- Rule 5.87: Rule 5.87(f) describes when a Floor Broker is entitled to cross a certain percentage of an order, subject to the requirements in that paragraph. Under that Rule, the Exchange may determine on a class-by-class basis the eligible size for an order that may be transacted pursuant to this paragraph; however, the eligible order size may not be less than 50 standard option contracts (or 500 mini-option contracts or 5,000 for micro-options). The proposed rule change adds that 5,000 FLEX Index Option contracts with an index multiplier of one is the corresponding minimum size for orders that may be crossed in accordance with this provision. Additionally, Rule 5.87, Interpretation and Policy .07(a) provides that Rule 5.86(e)<sup>19</sup> does not prohibit a Trading Permit Holder

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<sup>19</sup> Rule 5.86(e) provides that it will be considered conduct inconsistent with just and equitable principles of trade for any TPH or person associated with a TPH, who has knowledge of all material terms and conditions of an original order and a solicited order, including a facilitation order, that matches the original order's limit, the execution of which are imminent, to enter, based on such knowledge, an order to buy or sell an option of the same class as an option that is the subject of the original order, or an order to buy or sell the security underlying such class, or an order to buy or sell any related instrument

(“TPH”) from buying or selling a stock, security futures or futures position following receipt of an order, including an option order, but prior to announcing such order to the trading crowd, provided that the option order is in a class designated as eligible for “tied hedge” transactions and within the eligibility size parameters, which are determined by the Exchange and may not be smaller than 500 standard option contracts (or 5,000 mini-option contracts or 50,000 micro-options). The proposed rule change adds that 50,000 FLEX Index Option contracts with a multiplier of one is the corresponding minimum size for orders that may qualify as tied hedge transactions and not be deemed a violation of Rule 5.86(e).

#### Position and Exercise Limits<sup>20</sup>

The proposed rule change amends Rule 8.35(a) regarding position limits for FLEX Options to describe how Micro FLEX Index Options will be counted for purposes of determining compliance with position limits.<sup>21</sup> Because 100 Micro FLEX Index Options are equivalent to

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until either (1) all the terms and conditions of the original order and any changes in the terms and conditions of the original order of which that Trading Permit Holder or associated person has knowledge are disclosed to the trading crowd or (2) the solicited trade can no longer reasonably be considered imminent in view of the passage of time since the solicitation. An order to buy or sell a “related instrument,” means, in reference to an index option, an order to buy or sell securities comprising ten percent or more of the component securities in the index or an order to buy or sell a futures contract on any economically equivalent index.

<sup>20</sup> This discussion focuses on position and exercise limits with respect to indexes on which the Exchange currently lists standard options and may also list Micro FLEX Index Options. To the extent the Exchange lists Micro FLEX Index Options on other indexes in the future, they would be subject to the same position and exercise limits set forth in the applicable Rules, and similarly aggregated with standard options on the same indexes, as proposed.

<sup>21</sup> The proposed rule change also corrects an administrative error in Rule 8.35(a). Currently, there are two subparagraphs numbered as (a)(5). The proposed rule change amends paragraph (a) to renumber the second subparagraph (a)(5) to be subparagraph (a)(6).

one FLEX Index Option with a multiplier of 100 overlying the same index due to the difference in contract multipliers, proposed Rule 8.35(a)(7) states that for purposes of determining compliance with the position limits under Rule 8.35, 100 Micro FLEX Index Option contracts equal one FLEX Index Option contract with a multiplier of 100 with the same underlying index. The proposed rule change makes a corresponding change to Rule 8.35(b) to clarify that, like reduced-value FLEX contracts, Micro FLEX Index Option contracts will be aggregated with full-value contracts and counted by the amount by which they equal a full-value contract for purposes of the reporting obligation in that provision (*i.e.*, 100 Micro FLEX Index Options will equal one FLEX Index Option contract with a multiplier of 100 overlying the same index).<sup>22</sup> The proposed rule change also adds that Micro FLEX Index Options on certain broad-based indexes for which FLEX Index Options with a multiplier of 100 have no position limits will also have no position limits. The proposed rule change amends Rule 8.42(g) to make corresponding changes regarding the application of exercise limits to Micro FLEX Index Options. This is consistent with the current treatment of other reduced-value FLEX Index Options with respect to position and exercise limits. The margin requirements set forth in Chapter 10 of the Rules will apply to FLEX Micro Options (as they currently do to all FLEX Options).<sup>23</sup>

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<sup>22</sup> As it does today with respect to reduced-value indexes, the Exchange will count Micro FLEX Index Options as a percentage of a FLEX Index Option with a multiplier of 100 when calculating positions to determine compliance with position limits. For example, currently, since 10 XSP contracts equals 1 SPX contract, 5 XSP contracts equals 0.5 SPX contracts for position limit purposes. With respect to Micro FLEX Index Options, since 100 Micro FLEX SPX Options equals 1 FLEX SPX Option, 4 Micro FLEX SPX Options will equal 0.47 FLEX SPX Options for purposes of position limits.

<sup>23</sup> Pursuant to Rule 8.43(j), FLEX Index Options with a multiplier of one will be aggregated with non-FLEX Index Options on the same underlying index in the same manner as all other FLEX Index Options.

### Capacity

The Exchange has analyzed its capacity and represents that it believes the Exchange and Options Price Reporting Authority (“OPRA”) have the necessary systems capacity to handle the additional traffic associated with the listing of new series that may result from the introduction of the Micro FLEX Index Options. Because the proposed rule change is limited to broad-based index options, which currently represent only 13 of the indexes on which the Exchange listed on the Exchange, the Exchange believes any additional traffic that may be generated from the introduction of Micro FLEX Index Options will be manageable. The Exchange also understands that the OCC will be able to accommodate the listing and trading of Micro FLEX Index Options.

### Nonsubstantive and Clarifying Changes

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. 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. 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) \$0.01, if the exercise price for the FLEX Option series is expressed as a fixed price in terms of dollars and decimals or a specific index value, as applicable, or (b) 0.01%, if the exercise price for the FLEX Option series is expressed as a percentage of the closing value of the underlying equity security or index on the trade date, as applicable.<sup>24</sup> The minimum permissible amounts of \$0.01 and 0.01% for FLEX Options with fixed exercise prices and percentage exercise prices, respectively, submitted into 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 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 Rule 4.21(b)(6) after subparagraph (B) 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

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<sup>24</sup> The proposed rule change makes nonsubstantive changes to the structure of this sentence to accommodate the addition of the specific minimum increments for the exercise price.

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.<sup>25</sup>

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) so that it applies only to that subclause. While not specified in the Rules, such rounding would only occur for exercise prices expressed as a percentage, so the proposed rule clarifies that it applies only for exercise prices expressed as a percentage and specifies that the System rounds the actual exercise prices 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

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<sup>25</sup> 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).

closing value is available would be rounded to the nearest minimum dollar value increment, which dollar value would represent the ultimate, “actual” exercise price.

Similarly, the proposed rule change clarifies in Rule 5.3(e)(3) and 5.4(c)(4) that the System rounds the final transaction prices (rather than bids and offers) of FLEX Options to the nearest fixed price minimum increment for the class as set forth in Rule 5.4(c)(4)(A) following application of the designated percentage to the closing value of the underlying security or index. This is consistent with current functionality and is merely a clarification in the Rules to more accurately reflect how the System currently works. For example, suppose a FLEX Trader enters a percentage bid of 0.27 for a FLEX Equity Option, which is the price at which the order for that option ultimately trades, and the underlying security has a closing value of 24.52 on the trade date. Following the close on the trade date, the System calculates the transaction price to be 6.6204 ( $0.27 \times 24.52$ ). Assuming the minimum increment for bids and offers in a FLEX Option class is \$0.01, the System rounds 6.6204 to the nearest penny, which would be a transaction price of \$6.62. 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.

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), rather than bids and offers. 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. The proposed rule change replaces the phrase “bids and offers” with “final transaction prices” in Rules 5.3(e)(3) and 5.4(c)(4). This is consistent with current functionality and is merely a clarification in the Rules to more accurately reflect how the System currently works. 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).<sup>26</sup> At that time, the System also determines the final transaction price in dollars to be \$3.34 (rounded from 3.338).<sup>27</sup>

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

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<sup>26</sup> 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 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.

<sup>27</sup> 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.

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 the first paragraph of Rule 5.3(e)(3)(B) (as described above) 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 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.<sup>28</sup> 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

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<sup>28</sup> 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.

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.

Finally, in Rule 4.22(b), the proposed rule change modernizes (and moves to make clear it will apply to the entire paragraph (b) (as proposed to be amended) the provision regarding how FLEX Traders are notified when a FLEX Option series becomes restricted. Currently, Rule 4.22(b) states a FLEX Official announces to FLEX Traders when such a FLEX Option series is restricted to closing only transactions. This was true when FLEX Options were traded only in open outcry and a verbal announcement was made to the trading floor. Currently, because FLEX Options are available for electronic and open outcry trading, the Exchange notifies FLEX Traders when a FLEX Option series is restricted to closing only transactions. In accordance with Rule 1.5, the Exchange currently notifies FLEX Traders of restricted FLEX Option series by electronic message.

## 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.<sup>29</sup> Specifically, the

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<sup>29</sup> 15 U.S.C. 78f(b).

Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>30</sup> 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)<sup>31</sup> 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 remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, protect investors and the public interest. The Exchange believes the proposed rule change will expand investor choice and flexibility by providing investors with the ability to gain exposure to the market using FLEX Index options with a notional value of 1/100<sup>th</sup> of the value of current FLEX Index options. The Exchange believes there is unmet market demand from market participants for Micro FLEX Index Options. Micro FLEX Index Options will provide additional granularity with respect to the prices at which investors may execute and exercise index options on the Exchange. Micro FLEX Index Options will provide investors with an exchange-traded tool to manage more precisely based on notional value the positions and associated risk in their portfolios, which currently may equal a fraction of a standard contract. Because Micro FLEX Index Options and standard FLEX Index Options (as well as non-FLEX index options) will

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<sup>30</sup> 15 U.S.C. 78f(b)(5).

<sup>31</sup> Id.

overlie the same indexes, market participants may use them as hedging vehicles to meet their investment needs in connection with index-related products and cash positions in a similar manner as they currently do with standard FLEX Index Options, but as a more manageably sized contract. The smaller-sized contract will provide all market participants with more precision with respect to hedging their portfolios more effectively with far greater precision. Given the various trading and hedging strategies employed by investors, this additional granularity may provide investors with more control over the trading of their investment strategies and management of their positions and risk associated with option positions in their portfolios.

Additionally, Micro FLEX Index Options will provide investors with the ability to execute and exercise options with a smaller index multiplier in a listed market environment as opposed to in the unregulated OTC options market. The proposed rule change may shift liquidity from the OTC market onto the Exchange, which the Exchange believes would increase market transparency as well as enhance the process of price discovery conducted on the Exchange through increased order flow to the benefit of all investors. By permitting index options to trade with the same multiplier currently available to customized options in the OTC market, the Exchange believes the proposed rule change will also promote competition and remove impediments to and perfects 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 Exchange products 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 OCC as issuer and guarantor of all listed options.

The listing of Micro FLEX Index Options has the same practical effect as the listing of FLEX Index Options on reduced-value indexes, which the Exchange (and other options exchanges) currently has the authority to do with respect to several indexes (in accordance with previously Commission-approved rules). For example, the Exchange may list FLEX Options on both the S&P 500 Index (SPX options) and the Mini-S&P 500 Index (XSP options), which is 1/10<sup>th</sup> the value of the S&P 500 Index.<sup>32</sup> This is economically equivalent to if the Exchange listed an S&P 500 Index option with an index multiplier of 100 and with an index multiplier of 10, respectively. The Commission approved the Exchange's authority to list non-FLEX Options on broad-based indexes with a value of at least 100 with an index multiplier of 1, and the proposed rule change extends that authority to list FLEX Options on the same indexes.<sup>33</sup>

As described above, the proposal contains a number of features designed to protect investors by reducing investor confusion. For example, Micro FLEX Index Options will be designated by different trading symbols from standard FLEX Index Options. Additionally, the proposed rule change describes in the Rules the differences regarding the meanings of bids and offers, exercise prices (and thus deliverables), and minimum sizes of index options contracts with a multiplier of one and a multiplier of 100, all of which are adjusted proportionately to reflect the difference in multiplier, and thus the difference in the deliverable value of the

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<sup>32</sup> The Exchange notes if it desired to list a reduced-value index option on other indexes, or list an option on a micro-level index (i.e., an index with 1/100<sup>th</sup> the value of the full-sized index), it could do so without Commission approval if the underlying index satisfied the generic listing criteria in Rule 4.12.

<sup>33</sup> See Securities and Exchange Act Release No. 91528 (April 9, 2021), 86 FR 19933 (April 15, 2021) (SR-CBOE-2020-117) (Commission approval of micro-options).

underlying.<sup>34</sup> The Exchange believes the transparency and clarity the proposed rule change adds to the Rules regarding the distinctions between index options due to the different multipliers will benefit investors. These proposed changes are not novel, as they correspond to similar rule provisions regarding other reduced-value options.<sup>35</sup>

Other than these differences, Micro FLEX Index Options will trade in the same manner as all other FLEX Index Options. Because Micro FLEX Index Options and standard FLEX Index Options (and non-FLEX options) overlie the same indexes, market participants may use Micro FLEX Index Options as hedging vehicles to meet their investment needs in connection with index-related products and cash positions in a similar manner as they do with standard index options, but as a more manageably sized contract. The smaller-sized contract may provide market participants with more precision with respect to hedging their portfolios. Therefore, the Exchange believes it is reasonable and appropriate to permit FLEX Traders to trade Micro FLEX Index Options in the same manner as all other FLEX Options.

The Exchange believes the proposed rule change regarding the treatment of Micro FLEX Index Options with respect to determining compliance with position and exercise limits is designed to prevent fraudulent and manipulative acts and practices and promote just and equitable principles of trade. Micro FLEX Index Options will be counted for purposes of those

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<sup>34</sup> These proposed changes correspond to similar provisions for mini-options and micro-options, which also have a smaller multiplier than standard-sized options.

<sup>35</sup> See, e.g., Rules 4.5, Interpretation and Policy .18 (description of strike prices for mini-options, which have a multiplier of 10), 5.3(c) (description of bids and offers for mini-options and micro-options), and 5.74(a)(4) (description of minimum size of FLEX Agency Order for mini-options and micro-options). Just as terms for micro-options, which have a multiplier of 1/100<sup>th</sup> the size of standard options, equal 1/100<sup>th</sup> of the same terms for standard options, the proposed terms for Micro FLEX Index Options, which have a multiplier 1/100<sup>th</sup> the size of FLEX Index Options with a multiplier of 100, equal 1/100<sup>th</sup> of the same terms as FLEX Index Options with a multiplier of 100.

limits in a proportional manner to FLEX Index Options (including reduced-value indexes) with a multiplier of 100 and aggregated with FLEX Index Options overlying the same index (including reduced-value indexes) and non-FLEX Options in the same manner as index options currently are. This is equivalent to current limits imposed on reduced-value options and micro-options. As noted above, while the multipliers of reduced-value indexes are \$100, a reduced-value index option has an economically equivalent effect to an index option with a smaller multiplier. An index option with a multiplier of one corresponds to an option overlying a reduced-valued index that is 1/100<sup>th</sup> the value of the full-value index. It just uses a different multiplier rather than a different value of the underlying index.<sup>36</sup> The Exchange believes its surveillances continue to be designed to deter and detect violations of Exchange Rules, including position and exercise limits and possible manipulative behavior, and those surveillance will apply to index options with a multiplier of one that the Exchange determines to list for trading. Ultimately, the Exchange does not believe that this proposed rule change raises any unique regulatory concerns because existing safeguards — such as position and exercise limits (and the aggregation of options overlying the same index (including reduced-value indexes)) and reporting requirements — would continue to apply.

The Exchange represents that it has the necessary systems capacity to support the new option series given these proposed specifications. The Exchange believes that its existing surveillance and reporting safeguards are designed to deter and detect possible manipulative behavior which might arise from listing and trading Micro FLEX Index Options. The Exchange further notes that current Exchange Rules that apply to the trading of other FLEX Index Options

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<sup>36</sup> This is also similar to position limits for other options with multipliers less than 100. See, e.g., Rule 8.30, Interpretation and Policy .08 (describing position limits for mini-options).

traded on the Exchange will also apply to the trading of Micro FLEX Index Options, such as Exchange Rules governing customer accounts, margin requirements and trading halt procedures. The Exchange understands that market participants may currently, and currently do, execute orders in options like the ones being proposed in the unregulated OTC options market, where neither the Exchange nor the Commission has oversight over market participants that may be purposely trading at prices through the listed market. The proposed rule change may encourage these orders to be submitted to the Exchange, which could bring these orders into a regulated market and be subject to surveillance and oversight to which they are currently not subject with respect to execution of these option orders.

The Exchange believes the proposed rule change will protect investors by preventing a Micro FLEX Index Option series to be listed with the same terms as a non-FLEX Index Option. Therefore, Micro FLEX Index Options will be permissible with the same terms as FLEX Index Options with a multiplier of 100 are currently available for trading. The Exchange believes this restriction eliminates any possible price protection concerns that permitting a FLEX Option with the same terms a but a different index multiplier than a non-FLEX Option on the same underlying index may allow FLEX options with a multiplier of one to gain priority over customer orders on the book for similar non-FLEX index options overlying the same index and to bypass or trade through the NBBO in non-FLEX options, potentially leading to market fragmentation.

The Exchange believes the proposed rule change will move volume currently being executed in the OTC market to the Exchange. As discussed above, the precision the proposed rule change will add to the Exchange is currently available in the OTC market, and the Exchange understands this precision is necessary for certain market participants' investment strategies. The

Exchange has heard from numerous institutional investors — insurance companies, in particular — who use index options to hedge their portfolio risk. These investors have indicated they execute a significant portion of their hedging transactions in the OTC market because the Exchange does not offer a product that provides them with the level of precision they need for their hedging activity. However, they have expressed their preference to transact on the Exchange to eliminate the counterparty risk they must incur by trading in the OTC market. The Exchange understands that it is a critical and regular part of an insurance company's business to hedge their risk, which many do with index options. When insurance companies issue policies to their customers, those companies accumulate liabilities for the payouts they may need to make to their customers pursuant to those policies. Insurance companies regularly hedge the notional amount of these liabilities to protect against downturns in the market. Because they are looking to protect against broad market downturns, broad-based index options are a tool insurance companies often use for this protection. One insurance company informed the Exchange that it has hedged approximately 25% of the notional value of its \$40 billion portfolio with index options executed in the OTC market, and the Exchange understands several other companies have similarly used index options to hedge significant portions of their portfolios. Given the size of insurance companies' portfolios, which can be in the tens of billions of dollars, that translates to index options with an aggregate notional value of billions of dollars being transacted annually in the nontransparent, unregulated, and riskier OTC market (where there is counterparty risk and no price protection exists for these customers).

For a customer to achieve a precise hedge for a specific notional value amount using currently available products on the Exchange, the Exchange understands a customer would need to make at least four separate trades (which multiple trades introduce additional costs, inefficiencies, and execution risk) to achieve a result close to identical to the result it could achieve with a single

trade in the OTC market. The inability of insurance companies to precisely hedge the notional value of their portfolios ultimately harms their customers. If an insurance company, for example, “underhedges” the notional value of its portfolio (which, again, is generally at least tens of billions of dollars), even 1% of such “slippage” would leave hundreds of millions of dollars of that portfolio unhedged,<sup>37</sup> which creates significant risk for that company.<sup>38</sup> Alternatively, if an insurance company “overhedges” the notional value of its portfolio, that would unnecessarily tie up some of its financial resources, as the difference in value of the options and the value of the portfolio is serving no purpose. Either case will likely result in higher premiums or reduced benefits for customers. As a result, because these companies are unable to achieve a more precise hedge on the Exchange, they turn to the OTC market where the precision they need to implement their hedging strategies more efficiently is available and not unnecessarily harm their customers.

For example, if an insurance company sells to a customer a \$247,589,000 annuity policy, the insurance company may seek to obtain positions in broad-based index options with an equivalent notional value. On the Exchange, if the company used SPX options, it would need 651 SPX contracts if the index level of the S&P 500 Index was 3801.19 ( $247,589,000/3801.19/100$ <sup>39</sup> = 651.34). However, 651 SPX contracts would equate to \$247,457,469, leaving that one policy underhedged by \$131,531. The company could also trade 6514 XSP options, which would equate to \$247,609,517, which would overhedge the policy by \$20,517 and unnecessarily use that amount of funds for hedging its portfolio rather than, for example, pay out insurance benefits to

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<sup>37</sup> For example, if an insurance company has a \$40,000,000,000 portfolio, 1% of that portfolio equates to \$400,000,000.

<sup>38</sup> The Exchange notes the total unhedged risk across the insurance industry would be multiplied if each insurance company were unable to hedge the full notional value of its portfolio.

<sup>39</sup> The index multiplier is 100.

customers.<sup>40</sup> With a one multiplier, the company could instead trade 65135 FLEX SPX Option contracts with a multiplier of one (as the company may do today in the OTC market), which would equate to \$247,590,511, which is far closer to the value of the policy and thus is the most efficient use of the insurance company's hedging resources.

This example demonstrates the value one insurance company could receive from the availability of FLEX Index Options with a multiplier of one for a hedge related to a single policy. The aggregate value to the insurance industry, and their customers, created by the availability of FLEX Index Options with a multiplier of one would be extensive if multiple insurance companies used these options to hedge their portfolios, as the Exchange expects them to do. As a result, a substantial number of index options transactions that currently occur with no transparency and counterparty risk would have the opportunity to receive the benefits of occurring on a national securities exchange. The availability of this product on the Exchange would provide these companies with a more transparent, lower risk option that would allow them to use their resources more efficiently and pass on those savings to their customers.

The Exchange's surveillance program will incorporate Micro FLEX Index Options. Broker-dealers are also subject to due diligence and best execution obligations, which obligations may require broker-dealers to consider the prices of economically equivalent options when executing customer orders. Market participants may currently, and the Exchange understands they currently do, execute orders like the ones being proposed in the unregulated OTC market, where neither the Exchange nor the Commission has oversight over market participants that may be purposely trading at prices through the listed market.

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<sup>40</sup> As this relates to only a single policy in the insurance company's portfolio, the harm that may be caused by the lack of precision only increases for each policy for which the company is unable to precisely hedge.

The Commission initially approved the listing and trading of FLEX Options on only two indexes – the S&P 100 and S&P 500.<sup>41</sup> As noted above, the Commission issued a separate order designating FLEX Options as standardized options under Rule 9b-1 of the Exchange Act, which order specifically referenced FLEX Options on those two indexes.<sup>42</sup> While the initial scope of FLEX Options was limited, the use of FLEX Options has significantly expanded since 1993. The Exchange may now list FLEX Options on any equity or index for which it is authorized to trade non-FLEX Options.<sup>43</sup> The expansion of the use of FLEX Options is consistent with the initial purpose for which the Exchange initially proposed to adopt FLEX Options, which was to permit trading in options that were otherwise permissible in the OTC market to provide investors with the benefits of trading options on a listed market versus the OTC market. Since 1993, the Commission, through designated authority, has approved numerous proposed rule changes to expand the applicability of FLEX Options and designated those FLEX Options as standardized options under Rule 9b-1 of the Exchange Act, including FLEX Options with terms different than those initially approved by the Commission in 1993.<sup>44</sup> The proposed rule change similarly seeks to expand the availability of FLEX Options in a manner consistent with the initial purpose for which the Exchange initially adopted, and has since then expanded the applicability of, FLEX Options. Options with an index multiplier of one are currently permissible in the OTC market but not in the listed market. The proposed rule change seeks to meet the demands of investors that currently may

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<sup>41</sup> See Securities Exchange Act Release No. 31920 (February 24, 1993), 58 FR 12280 (March 3, 1993) (SR-CBOE-92-17) (“Initial Cboe FLEX Approval”).

<sup>42</sup> See 1993 FLEX Approval Order.

<sup>43</sup> See Rule 4.20.

<sup>44</sup> Similar to previous changes in the past, the Commission has the authority to designate FLEX Options with an index multiplier of one to be standardized options pursuant to Rule 9b-1 under the Exchange Act if it believes such designation is appropriate.

only obtain more precise hedging as described above through the OTC markets. The Exchange believes it benefits the investing public to continue to enhance product offerings to evolve to constantly changing needs of investors, even if certain products were initially introduced in a more limited manner.

A robust and competitive market requires that exchanges respond to investors' evolving needs by constantly improving their offerings. When Congress charged the Commission with supervising the development of a "national market system" for securities, Congress stated its intent that the "national market system evolve through the interplay of competitive forces as unnecessary regulatory restrictions are removed.<sup>45</sup> Consistent with this purpose, Congress and the Commission have repeatedly stated their preference for competition, rather than regulatory intervention to determine products and services in the securities markets.<sup>46</sup> This consistent and considered judgment of Congress and the Commission is correct, particularly in light of evidence of robust competition in the options trading industry. The fact that an exchange proposed something new is a reason to be receptive, not skeptical — innovation is the life-blood of a vibrant competitive market — and that is particularly so given the continued internalization of

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<sup>45</sup> See H.R. Rep. No. 94-229, at 92 (1975) (Conf. Rep.).

<sup>46</sup> See S. Rep. No. 94-75, 94<sup>th</sup> Cong., 1st Sess. 8 (1975) ("The objective [in enacting the 1975 amendments to the Exchange Act] would be to enhance competition and to allow economic forces, interacting within a fair regulatory field, to arrive at appropriate variations in practices and services."); Order Approving Proposed Rule Change Relating to NYSE Arca Data, Securities Exchange Act Release No. 59039 (December 2, 2008), 73 FR 74770 (December 9, 2008) ("The Exchange Act and its legislative history strongly support the Commission's reliance on competition, whenever possible, in meeting its regulatory responsibilities for overseeing the [self-regulatory organizations] and the national market system. Indeed, competition among multiple markets and market participants trading the same products is the hallmark of the national market system."); and Regulation NMS, 70 FR at 37499 (observing that NMS regulation "has been remarkably successful in promoting market competition in [the] forms that are most important to investors and listed companies").

the securities markets, as exchanges continue to implement new products and services to compete not only in the United States but throughout the world. Options exchanges continuously adopt new and different products and trading services in response to industry demands in order to attract order flow and liquidity to increase their trading volume. This competition has led to a growth in investment choices, which ultimately benefits the marketplace and the public. The Exchange believes that the proposed rule change will help further competition by providing market participants with yet another investment option for the listed options market.

The Exchange believes the proposed nonsubstantive, codifying, and clarifying changes described above increase the transparency of the Rules and ultimately benefit investors. With respect to the codification of how FLEX orders and auction responses will be ranked, the Exchange believes ranking percentage-priced premiums at the time of the auction rather than after the close of trading (when the dollar amount of the price is determined) will promote just and equitable principles of trade because it is consistent with the ranking of dollar-priced premiums. This also provides FLEX Traders with real-time executions as opposed to waiting until the close of trading to know if it received an execution and, if so, for how many contracts. FLEX Traders are competing in auctions based on the percentage amount of their bids and offers (in the same manner they do with dollar bids and offers) and thus should be ranked based on that amount, as they do not know at the time of submitting those bids and offers to what final price they will be rounded. Like bids and offers in dollar amounts, the Exchange believes a FLEX Trader willing to pay more (or receive less) at the time of a FLEX Auction should receive priority. As long as it is possible that different percentage bids and offers could differ after the close of trading, the Exchange believes a more aggressive auction response bears the risk that the

adjusted price may also be more aggressive, and the responder should be rewarded for taking on that risk by receiving a higher ranking. The Exchange believes consistency in ranking of bids and offers submitted in all FLEX Auctions (and non-FLEX Auctions) will benefit investors, and providing FLEX Traders that submit more aggressive responses with priority will encourage FLEX Traders to submit competitive responses, which ultimately benefits investors as well.

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 will impose any burden on intramarket competition that is not necessary or appropriate in furtherance of the purposes of the Act as any Micro FLEX Index Options the Exchange lists for trading will be available for all market participants in the same manner who wish to trade such options. The Exchange may list Micro FLEX Index Options for trading on all broad-based indexes with a value of at least 100 currently authorized to be listed on the Exchange, subject to the same listing criteria (the Exchange is currently authorized to list micro-options on the same indexes). These options will trade in the same manner as FLEX Index Options with a multiplier of 100, with certain terms proportionately adjusted to reflect the different contract multipliers.

The Exchange does not believe the proposed rule change will impose any burden on intermarket competition that is not necessary or appropriate in furtherance of the purposes of the Act because Micro FLEX Index Options may only be listed for trading on the Exchange. To the extent that the availability of these products makes the Exchange a more attractive marketplace to market participants at other exchanges, market participants are free to elect to become market participants on the Exchange. As noted above, other derivative products related to these indexes are listed for trading on other exchanges. Additionally, the Exchange notes that listing and

trading Micro FLEX Index Options on the Exchange will subject such options to transparent exchange-based rules as well as price discovery and liquidity, as opposed to alternatively trading these products in the OTC market.

The Exchange believes that the proposed rule change may relieve any burden on, or otherwise promote, competition. The proposal is designed to increase competition for order flow on the Exchange in a manner that is beneficial to investors by providing them with a lower-cost option to hedge their investment portfolios. The Exchange notes that it operates in a highly competitive market in which market participants can readily direct order flow to competing venues who offer similar products. 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 contract granularity that 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 will 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 all listed options.

The proposed nonsubstantive, clarifying, and codifying changes will have no impact on competition, as they merely clarify or codify information in the Rules and make no changes to how FLEX Options trade. With respect to the codification of how FLEX orders and auction responses will be ranked, the Exchange believes the proposed rule change will not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the

Act, because it will rank FLEX orders and auction responses in the same manner regardless of the form of the exercise price of a series.

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 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](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2021-041 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-2021-041. 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-2021-041, 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.<sup>47</sup>

J. Matthew DeLesDernier  
Assistant Secretary

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<sup>47</sup> 17 CFR 200.30-3(a)(12).