SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-96684; File No. SR-CBOE-2022-051)

January 18, 2023

Self-Regulatory Organizations; Cboe Exchange, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend Rules Relating to the Processing of Auction Responses

On October 3, 2022, Cboe Exchange, Inc. ("the Exchange" or "Cboe Options") filed with the Securities and Exchange Commission (the "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),[1] and Rule 19b-4 thereunder,[2] a proposed rule change to amend its rules relating to the processing of auction responses. The proposed rule change was published for comment in the Federal Register on October 20, 2022.[3] On November 23, 2022, pursuant to Section 19(b)(2) of the Act,[4] the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.[5] The Commission has received no comments on the proposed rule change. This order institutes proceedings under Section 19(b)(2)(B) of the Act[6] to determine whether to approve or disapprove the proposed rule change.

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

[2]   17 CFR 240.19b-4.

[3]   See Securities Exchange Act Release No. 96081 (Oct. 14, 2022), 87 FR 63830 ("Notice").

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

[5]   See Securities Exchange Act Release No. 96380, 87 FR 73366 (Nov. 29, 2022). The Commission designated January 18, 2023 as the date by which the Commission shall approve or disapprove, or institute proceedings to determine whether to disapprove, the proposed rule change.

[6]   15 U.S.C. 78s(b)(2)(B).

I.   Summary of the Proposed Rule Change[7]

The Exchange proposes to adopt new functionality that would be applicable to all of its auction mechanisms, to increase the likelihood that timely submitted auction responses may participate in the applicable auction, even during periods of high message traffic. The affected auctions are the Complex Order Auction,[8] Step Up Mechanism,[9] Automated Improvement Mechanism,[10] Complex AIM,[11] Solicitation Auction Mechanism,[12] Complex SAM,[13] FLEX Auction Process,[14] FLEX AIM[15] and FLEX SAM.[16] The Exchange also proposes to amend its current rule relating to Priority Queue[17] functionality to provide itself with discretion on whether or not to implement Priority Queue[18] functionality for responses to the auction mechanisms.

The Exchange represents that the above-referenced auction mechanisms provide price improvement opportunities for an eligible order. Within each auction mechanism, the eligible order is electronically exposed for an Exchange-determined period of time ("auction response period") in accordance with the applicable Exchange Rule.[19] After the Exchange disseminates

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[7]   For a full description of all aspects of the proposed rule change, please see the Notice, supra note 3.

[8]   See Cboe Rule 5.33(d).

[9]   See Cboe Rule 5.35.

[10]   See Cboe Rule 5.37.

[11]   See Cboe Rule 5.38.

[12]   See Cboe Rule 5.39.

[13]   See Cboe Rule 5.40.

[14]   See Cboe Rule 5.72(c).

[15]   See Cboe Rule 5.73.

[16]   See Cboe Rule 5.74.

[17]   See Cboe Rule 5.25(c).

[18]   See Cboe Rule 5.25(c).

[19]   See Notice, supra note 3, at 63831.

an auction notification message, Users[20] may submit responses ("auction responses" or "auction response messages") during the auction response period.[21] An auction response may only execute in the applicable auction mechanism, and the auction response is cancelled if it does not execute during an auction.[22]

The Exchange states that auction response messages historically have waited in the same System[23] queue as all other order and quote message traffic.[24] According to the Exchange, if an auction response is submitted when there is a deep queue of other unprocessed message traffic (such as mass cancellation messages or other orders and quotes), it is possible that the auction response may not be "processed" by the System prior to the end of the auction response period,[25] The Exchange states that in such an instance, the queued auction response may not be able to

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[20]   The term "User" means any Trading Permit Holder or Sponsored User who is authorized to obtain access to the System pursuant to Cboe Rule 5.5. See Cboe Rule 1.1.

[21]   See Notice, supra note 3, at 63831.

[22]   See id.

[23]   The term "System" means the Exchange's hybrid trading platform that integrates electronic and open outcry trading of option contracts on the Exchange, and includes any connectivity to the foregoing trading platform that is administered by or on behalf of the Exchange, such as a communications hub. See Cboe Rule 1.1.

[24]   Although the Exchange previously adopted Priority Queue functionality, which provides that auction response messages may be processed through a Priority Queue, and all remaining messages would be processed through a General Queue, the Exchange never implemented use of the functionality. See Notice, supria note 3 at 63832. The Exchange states that, should it decide to implement use of a Priority Queue in the future, it would provide notice to all TPHs. Id.

[25]   For example, the Exchange states that it takes the System approximately 10 microseconds to process a single order/quote or auction response message and, on average, approximately 190 microseconds to process a mass cancel message. As such, under the current System, an auction response that is entered after a mass cancel message is more likely to be detrimentally delayed as compared to a mass cancel message that is entered after an auction response (i.e., a 190 microsecond "wait time" versus a 10 microsecond "wait time"). See id.

participate in the applicable auction mechanism because the System had unprocessed (queued) messages at the time of the auction execution, despite the fact that the User submitted the auction response prior to the end of the auction response period.[26] The Exchange believes that auctioned orders may therefore be missing out on potential price improvement that may have otherwise resulted if queued timely auction response(s) were able to participate in the auction.[27] The Exchange further states that its review of auction responses during July 2022 indicates that approximately 55% of auction responses had no opportunity to execute in their respective auctions, notwithstanding being submitted within the auction response period.[28]

The Exchange thus proposes to adopt new functionality under proposed Cboe Rule 5.25(e), which would apply across all of its auction mechanisms. Under the proposed functionality, at the time an auction response period ends, the System would continue to process its inbound queue for any messages that were received before the end of the auction period (including auction messages) for up to an Exchange-determined period of time, not to exceed 100 milliseconds (which the Exchange may determine on a class-by-class basis).[29] The Exchange states that under the proposed rule change, any auction responses that were in the queue before the conclusion of the auction (as identified by the Network Interface Card ("NIC") timestamp on the message)[30] would be processed as long as the Exchange-determined time on a class-by-class basis (not to exceed 100 milliseconds) is not exceeded.[31] Only auction messages

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[26]   See id.

[27]   See id.

[28]   See id.

[29]   See id.

[30]   All incoming messages are "timestamped" by the Exchange's System. See Notice, supra note 3, at id. n14.

[31]   See Notice, supra note 3, at 63831.

received prior to the execution of the applicable auction are eligible to be processed for that auction.[32] The applicable auction mechanism would execute once all messages, including auction responses, received before the end time of the auction response period have been processed or the Exchange-determined maximum time limit of up to 100 milliseconds has elapsed, whichever occurs first.[33]

The Exchange believes the proposed functionality will increase the possibility that timely-submitted auction responses are processed by the Exchange and have an opportunity for execution in the applicable auction mechanism, even if there is a deep pending message queue.[34] The Exchange also believes the proposed maximum amount of additional time for processing is both an adequate amount of time to provide pending auction responses with such execution opportunity, but also an amount minimal enough that impact to other message traffic, if any, would be de minimis.[35]

Currently, Cboe Rule 5.25 provides that all Auction response messages will be processed through the Priority Queue, and all remaining messages will be processed through the General Queue. The proposed rule change would amend Cboe Rule 5.25 to provide the Exchange with the discretion to determine whether or not to implement a Priority Queue and a General Queue.[36] The Exchange states that under a Priority Queue, the System processes a certain number of

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[32]   See id.

[33]   See id. For an example of how the proposed new functionality would operate, please see id.

[34]   See Notice, supra note 3, at 63832.

[35]   See id. The Exchange states that based on the Exchange's analysis, in July 2022, auction response messages accounted for a mere 0.04% of all message traffic submitted to the Exchange. See Notice, supra note 3, at 63833.

[36]   See Notice, supra note 3, at 63832. Cboe Rule 5.25(c) currently states that all messages will be processed through either a "Priority Queue" or a "General Queue."

messages, as determined by the Exchange, from each queue on an alternating basis and prioritize processing messages in each respective queue in the order in which the System receives them (i.e., in time priority).[37] While the Exchange proposes to provide itself the discretion to implement or not implement a Priority Queue, the Exchange states that it currently anticipates implementing the proposed additional processing time functionality at this time in lieu of a Priority Queue.[38] The Exchange states that if it determines that utilization of a Priority Queue for auction responses is necessary or appropriate, it would provide notice to all TPHs pursuant to Cboe Rule 1.5.[39]

II.   Proceedings to Determine Whether to Approve or Disapprove SR-Cboe-2022-051 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act[40] to determine whether the proposed rule change should be approved or disapproved. Institution of proceedings is appropriate at this time in view of the legal and policy issues raised by the proposal. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as described below, the Commission seeks and encourages interested persons to provide additional comment on the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Act,[41] the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to

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[37]   See id.

[38]   See id.

[39]   See id.

[40]   15 U.S.C. 78s(b)(2)(B).

[41]   Id.

allow for additional analysis of, and input from commenters with respect to, the consistency of

the proposal with Sections 6(b)(5)[42] and 6(b)(8)[43] of the Act. Section 6(b)(5) of the Act requires

that the rules of a national securities exchange be designed, among other things, to promote just

and equitable principles of trade, to remove impediments to and perfect the mechanism of a free

and open market and a national market system and, in general, to protect investors and the public

interest, and not be designed to permit unfair discrimination between customers, issuers, brokers,

or dealers. Section 6(b)(8) of the Act requires that the rules of a national securities exchange not

impose any burden on competition that is not necessary or appropriate in furtherance of the

purposes of the Act. The Commission asks that commenters address the sufficiency of the

Exchange's statements in support of the proposal, which are set forth in the Notice,[44] in addition

to any other comments they may wish to submit about the proposed rule change. In particular,

the Commission seeks comment on the following aspects of the proposal and asks commenters to

submit data where appropriate to support their views:

1.   The Exchange proposes an extension of the processing time for auction responses

received prior to the end of the auction response or exposure period, not to exceed 100

milliseconds. The Exchange believes that modifying its System to allow it to potentially process

more, if not all, timely submitted auction responses may provide further opportunities for

auctioned orders to receive price improvement, which removes impediments to a free and open

market and ultimately protects and benefits investors[45] What are commenters' views on the

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[42]   15 U.S.C. 78f(b)(5).

[43]   15 U.S.C. 78f(b)(8).

[44]   See Notice, supra note 3.

[45]   See id. at 63832.

extent to which an extension of the processing time could result in further opportunities for price improvements for auctioned orders?

2.   The Exchange acknowledges that instead of proposing an extension of processing time beyond the end of the auction or exposure period, the Exchange "may increase the length of auction response periods to accommodate more auction responses."[46] However, the Exchange states that it believes the proposed rule change will "accommodate more auction responses and allow the Exchange to continue to mitigate the market risk that may accompany a longer auction period for auctioned orders by setting the length of an auction response period to a timeframe that allows an adequate amount of time for TPHs to respond to an auction message and providers orders with fast executions."[47] Do commenters agree with the Exchange's assessment? Why or why not?

3.   The Exchange states that adopting the proposed functionality for auction responses would "better provide customers with additional opportunities for price improvements with little to no impact to non-auction response message traffic."[48] The Exchange states that in July 2022, auction response messages accounted for a "mere 0.04% of all message traffic submitted to the Exchange. The Exchange believe[s] the processing of such a small account of message traffic, even after the conclusion of an auction response period, would therefore have de minimis, if any, impact on the process of non-auction response messages waiting in the queue."[49] What are commenters' views on the impact of the proposed rule change on the processing of non-auction message traffic?

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[46]   See id.

[47]   See id.

[48]   See id. at 63833.

[49]   See id.

4.   The Exchange states that the proposed additional processing time of up to 100

milliseconds "is both an adequate amount of time" to provide pending auction responses with

"execution opportunities, but also an amount minimal enough that impact to other message

traffic, if any, would be de minimis."[50] What are commenters' views regarding the sufficiency

of the proposed 100 millisecond time period for additional processing?

5.   The Exchange proposes in Cboe Rule 5.25 to give the Exchange discretion in whether or

not to utilize priority queue functionality for auction responses and states that the proposed

additional processing time for auction responses "is currently a better alternative to provide

timely submitted auction responses with opportunities to participate in an applicable auction as

compared to the priority queue functionality."[51] What are commenters' views on the ability of

the current priority queue functionality to address concerns regarding the System's inability to

timely process auction responses during the auction or exposure response period?

III.   Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their

data, views, and arguments with respect to the issues identified above, as well as any other

concerns they may have with the proposal. In particular, the Commission invites the written

views of interested persons concerning whether the proposed rule change is consistent with

Sections 6(b)(5) and 6(b)(8), or any other provision of the Act, or the rules and regulations

thereunder. Although there do not appear to be any issues relevant to approval or disapproval

that would be facilitated by an oral presentation of data, views, and arguments, the Commission

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[50]   See id. at 63832.

[51]   See id. at 63833.

will consider, pursuant to Rule 19b-4 under the Act,[52] any request for an opportunity to make an oral presentation.[53]

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule change should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register].

Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or

- Send an e-mail to rule-comments@sec.gov. Please include File No. SR-Cboe-2022-051 on the subject line.

Paper comments:

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

All submissions should refer to File No. SR-Cboe-2022-051. The file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all

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[52]   17 CFR 240.19b-4.

[53]   Section 19(b)(2) of the Act, as amended by the Securities Acts Amendments of 1975, Pub. L. 94-29 (Jun. 4, 1975), grants to the Commission flexibility to determine what type of proceeding – either oral or notice and opportunity for written comments – is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Acts Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies

of the submission, all subsequent amendments, all written statements with respect to the

proposed rule change that are filed with the Commission, and all written communications

relating to the proposed rule change between the Commission and any person, other than those

that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be

available for website viewing and printing in the Commission's Public Reference Room, 100 F

Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m.

and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the

principal office of the Exchange. All comments received will be posted without change.

Persons submitting comments are cautioned that we do not redact or edit personal identifying

information from comment submissions. You should submit only information that you wish to

make available publicly. All submissions should refer to File No. SR-Cboe-2022-051 and

should be submitted by [insert date 21 days from date of publication in the <u>Federal</u> <u>Register</u>].

Rebuttal comments should be submitted by [insert date 35 days from date of publication in the

<u>Federal</u> <u>Register</u>].

For the Commission, by the Division of Trading and Markets, pursuant to delegated

authority.[54]

Sherry R. Haywood

Assistant Secretary

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[54]   17 CFR 200.30-3(a)(57).