

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-80854; File No. SR-CBOE-2017-010)

June 2, 2017

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change Related to Unusual Market Conditions and the Duty to Systemize Non-Electronic Orders Prior to Representation

I. Introduction

On February 15, 2017, the Chicago Board Options Exchange, Incorporated (“Exchange” or “CBOE”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend its rules regarding the circumstances in which CBOE Floor Officials may declare a “fast” market and the actions those Floor Officials may take when a fast market is declared, including the ability to suspend the duty to systemize a non-electronic order prior to representing it in open outcry trading. The proposed rule change was published for comment in the Federal Register on March 6, 2017.³ The Commission received no comments on the proposed rule change. On April 18, 2017, pursuant to Section 19(b)(2) of the Exchange 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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 80123 (February 28, 2017), 82 FR 12667 (“Notice”).

⁴ 15 U.S.C. 78s(b)(2).

⁵ See Securities Exchange Act Release No. 80481, 82 FR 18941 (April 24, 2017). The Commission designated June 4, 2017, as the date by which the Commission shall either approve or disapprove, or institute proceedings to determine whether to disapprove, the

The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and to institute proceedings under Section 19(b)(2)(B) of the Exchange Act⁶ to determine whether to approve or disapprove the proposed rule change, as discussed in Section III below. The institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved, nor does it mean that the Commission will ultimately disapprove the proposed rule change. Rather, as described in Section III below, the Commission seeks and encourages interested persons to provide additional comment on the proposed rule change in order to inform the Commission's analysis of whether to approve or disapprove the proposed rule change.

II. Summary of Proposal

Currently, CBOE Rule 6.6(a) permits two Floor Officials to declare a market to be “fast” “because of an influx of orders or other unusual conditions or circumstances” when doing so would be in “the interest of maintaining a fair and orderly market.”⁷ Once a market is declared “fast,” Floor Officials have the authority to take a number of actions.⁸

In its filing, CBOE proposes several changes to Rule 6.6. First, CBOE proposes to amend paragraph (a) of the rule to require that at least one of the two Floor Officials that declares a fast market must be an Exchange employee. Additionally, the Exchange proposes to provide a non-exhaustive list of “unusual conditions or circumstances” that Floor Officials may consider when determining whether to declare a market to be “fast.” Specifically, proposed new language in Rule 6.6(a) would provide that: “[i]t may be in the interest of fair and orderly markets to

proposed rule change.

⁶ 15 U.S.C. 78s(b)(2)(B).

⁷ See CBOE Rule 6.6(a).

⁸ See CBOE Rule 6.6(b).

declare a fast market when one or more of the following conditions have been met: (i) the previous day's closing price of the S&P 500 Index is more than 2% away from the previous day's opening price; (ii) the front-month E-mini S&P 500 Future (symbol ES/1) is trading more than 20 points above or below the previous day's closing values by 8:00 AM CT; or (iii) the intraday price of the S&P 500 Index moves more than 1% in any one hour interval during regular trading hours.” In the Notice, CBOE acknowledges that some of these conditions occur with some degree of frequency,⁹ but nevertheless asserts that these measures could reflect volatile trading conditions.¹⁰ The Exchange asserts that including these guidelines in the rule text would give better notice to market participants as to when it might declare a fast market.¹¹

Further, CBOE proposes to allow two Floor Officials to suspend during a fast market the requirement of CBOE Rule 6.24 that non-electronic orders be systematized prior to representation on the trading floor.¹² During such a suspension, Trading Permit Holders (“TPHs”) and TPH organizations would be required to follow the procedures described in Rule 6.24(b), which require paper tickets to be used for orders received during a malfunction or disruption of the Exchange's systems.¹³ The Exchange also would require that, as soon as it declares an end to a fast market, TPHs would be required immediately to resume systematizing orders prior to representing them and use best efforts to, as soon as possible and no later than the

⁹ See Notice, supra note 3, at 12669 (noting that, over a prior eight month period, the intraday price of the S&P 500 Index had moved more than 1% in any one hour interval during regular trading hours on at least 30 days, which the Exchange categorized as a “not . . . infrequent occurrence”).

¹⁰ See id. at 12668-69.

¹¹ See id.

¹² See proposed Rule 6.6(b).

¹³ See proposed Rule 6.6.01.

close of business, input electronically into the Exchange's systems all relevant order information received during the time period when the order systematization requirement was suspended.¹⁴

In justifying its proposal, CBOE highlights that the risk that customers and market participants may experience losses if they miss the market as a result of the time required for TPHs to systematize orders, a risk that CBOE believes is exacerbated during fast markets when there can be an unusually large number of orders submitted to brokers and market prices can change quickly.¹⁵ The Exchange argues that market participants may be better served when the systemization requirement is suspended, which the Exchange believes could help TPHs more quickly execute orders in open outcry.¹⁶

The Exchange asserts that its proposed amendments to CBOE Rule 6.6 would not affect its ability to maintain an accurate audit trail.¹⁷ CBOE argues that suspending the systematization requirement during a fast market would merely delay its receipt of the audit trail information, because that information would still be recorded in a written form according to the procedures set forth under CBOE Rule 6.24, which currently applies only when orders are received during a malfunction or disruption of the Exchange's systems.¹⁸

Additionally, the Exchange asserts that the proposed rule change would not affect its ability to promptly report trade and quotation information to the Options Price Reporting Authority ("OPRA").¹⁹ The Exchange states that market participants would still be required to

¹⁴ See id.

¹⁵ See Notice, supra note 3, at 12669.

¹⁶ See id.

¹⁷ See id.

¹⁸ See id. Rule 6.24 does not explicitly require order details to be captured prior to representation of the order in open outcry.

¹⁹ See id. at 12670.

report the execution of orders within 90 seconds even where the systematization requirement had been suspended under proposed Rule 6.6.²⁰ Further, the Exchange states that its collection and reporting of quotation information to OPRA would not be affected by the proposed rule change; CBOE would continue to collect and transmit bids and offers at stated prices or limits with respect to individual securities in which it provides a market.²¹

III. Proceedings to Determine Whether to Approve or Disapprove SR-CBOE-2017-010 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act²² to determine whether the proposed rule change should be approved or disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as stated below, the Commission seeks and encourages interested persons to provide comments on the proposed rule change to inform the Commission's analysis of whether to approve or disapprove the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Exchange Act,²³ the Commission is providing notice of the grounds for disapproval under consideration, as discussed below. The Commission believes that instituting proceedings will allow for additional analysis of, and input from commenters with respect to, the proposed rule change's consistency with: (1) Section 6(b)(1) of the Exchange Act,²⁴ which requires that a national securities exchange is so organized and has

²⁰ See id.

²¹ See id.

²² 15 U.S.C. 78s(b)(2)(B).

²³ See id.

²⁴ 15 U.S.C. 78f(b)(1).

the capacity to be able to carry out the purposes of the Exchange Act and to comply, and to enforce compliance by its members and persons associated with its members, with the provisions of the Exchange Act, the rules and regulations thereunder, and the rules of the exchange; and (2) Section 6(b)(5) of the Exchange Act,²⁵ which requires that the rules of a national securities exchange be designed, among other things, to prevent fraudulent and manipulative acts and practices, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, and, in general, to protect investors and the public interest.

Specifically, the Commission is concerned whether the proposed rule change could adversely impact the ability of the Exchange to enforce compliance by its members on the CBOE trading floor with applicable rules and regulations, including CBOE rules designed to, among other things, ensure the integrity of its audit trail to help CBOE prevent fraudulent and manipulative acts and practices. In particular, the Commission wishes to consider further whether CBOE has sufficiently demonstrated how suspending the systemization requirement and relying upon paper tickets, where the order details are not captured prior to representation of the order in open outcry trading, in an environment of “extraordinary market volatility,” when TPHs may receive “an unusually large number of orders” and “market prices can change erratically, extremely quickly, and in enormous swings” will foster compliance with its audit trail rules, support the integrity of the audit trail and the Exchange’s surveillance that relies thereon, and not otherwise diminish the Exchange’s ability to ensure compliance with these critically important rules and thereby continue to maintain an accurate and reliable audit trail to support its

²⁵ 15 U.S.C. 78f(b)(5).

regulatory operations and obligations.²⁶

In its Notice for the current proposal, the Exchange asserts that its proposed amendments to CBOE Rule 6.6 would not affect its ability to maintain an accurate audit trail, but the Exchange does not discuss how or why its position on that issue has changed since first instituting the requirement in 2005.²⁷ The Commission is concerned whether CBOE's proposal to suspend the systemization requirement in a fast moving market is appropriately designed to support the integrity and reliability of its audit trail during active trading and, in turn, whether it is designed to support its surveillance program and thereby help prevent fraudulent and manipulative acts and protect investors and the public interest. Further, the Commission is concerned about the appropriateness of the Exchange's proposal to expand the application of Rule 6.24(b), which currently only allows order details to be recorded in paper form when CBOE's systems are down, to now allow paper tickets to be used during a "fast" market when CBOE's systems are working properly.

IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the 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 proposal is consistent with Sections 6(b)(1), 6(b)(5), 6(b)(8), or any other provision of the Exchange 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 views, data, and arguments, the Commission

²⁶ Notice, supra note 3, at 12668-69.

²⁷ See Notice, supra note 3, at 12669.

will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.²⁸

Interested persons are invited to submit written data, views, and arguments regarding whether the proposal should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register]. The Commission asks that commenters address the sufficiency of the Exchange's statements in support of the proposal, in addition to any other comments they may wish to submit about the proposed rule change.

Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-CBOE-2017-010 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 Numbers SR-CBOE-2017-010. 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

²⁸ Section 19(b)(2) of the Exchange Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding – either oral or notice and opportunity for written comments – is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act 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 these filings also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-CBOE-2017-010 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁹

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Assistant Secretary

²⁹ 17 CFR 200.30-3(a)(57).