

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-98044; File No. SR-CBOE-2023-036)

August 2, 2023

Self-Regulatory Organizations; Cboe Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Allow Certain Flexible Exchange Equity Options To Be Cash Settled

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 1, 2023, Cboe Exchange, Inc. (the “Exchange” or “Cboe Options”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. 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

The Exchange proposes to amend Rules 4.21 and 8.35 related to Flexible Exchange (“FLEX”) Options. The text of the proposed rule change is available on the Exchange’s website (<http://www.cboe.com/AboutCBOE/CBOELegalRegulatoryHome.aspx>), at the Exchange’s Office of the Secretary, and at the Commission’s Public Reference Room.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend Rules 4.21 and 8.35 related to FLEX Options. FLEX Options are customized equity or index contracts that allow investors to tailor contract terms for exchange-listed equity and index options. The Exchange proposes to amend Rule 4.21 to allow for cash settlement of certain FLEX Equity Options.³ Generally, FLEX Equity Options are settled by physical delivery of the underlying security,⁴ while all FLEX Index Options are currently settled by delivery in cash.⁵ As proposed, FLEX Equity Options where the underlying security is an Exchange-Traded Fund (“ETF”) would be permitted to be settled by delivery in cash if the underlying security meets prescribed criteria. The Exchange notes that cash-settled FLEX ETF Options will be subject to the same trading rules and procedures that currently govern the trading of other FLEX Options on the Exchange, with the exception of the rules to accommodate the cash-settlement feature proposed in this rule filing.

To permit cash settlement of certain FLEX ETF Options, the Exchange proposes new subparagraph (ii) to Rule 4.21(b)(5)(A). Proposed Rule 4.21(b)(5)(A)(ii) would provide that the exercise settlement for a FLEX ETF Option may be by physical delivery of the underlying ETF or by delivery in cash if the underlying security, measured over the prior six-month period, has an

³ A “FLEX Equity Option” is an option on a specified underlying equity security. See Cboe Options Rule 1.1.

⁴ See Rule 4.21(b)(5)(A)(i).

⁵ See Rule 4.21(b)(5)(B). As discussed below, cash settlement is also permitted in the over-the-counter (“OTC”) market.

average daily notional value of \$500 million or more and a national average daily volume (“ADV”) of at least 4,680,000 shares.⁶

The Exchange also proposes in the introductory paragraph of Rule 4.21(b) that a FLEX Equity Option overlying an ETF (cash- or physically settled) may not be the same type (put or call) and may not have the same exercise style, expiration date, and exercise price as a non-FLEX Equity Option overlying the same ETF.⁷ In other words, regardless of whether a FLEX Equity Option overlying an ETF is cash- or physically settled, at least one of the exercise style (i.e. American-style or European-style), expiration date, and exercise price of that FLEX Option must differ from those terms of a non-FLEX Option overlying the same ETF in order to list such a FLEX Equity Option. For example, suppose a non-FLEX SPY option (which is physically settled, p.m.-settled and American-style) with a September expiration and exercise price of 475 is listed for trading. A FLEX Trader could not submit an order to trade a FLEX SPY option (which is p.m.-settled) that is cash-settled (or physically settled) and American-style with a September expiration and exercise price of 475.

In addition, the Exchange proposes new subparagraph (a) to Rule 4.21(b)(5)(A)(ii), which would provide that the Exchange will determine bi-annually the underlying ETFs that satisfy the notional value and trading volume requirements in proposed Rule 4.21(b)(5)(A)(ii) by using trading statistics for the previous six-months.⁸ The proposed rule would further provide that the Exchange

⁶ See proposed Rule 4.21(b)(5)(A)(ii). The Exchange also proposes a corresponding nonsubstantive amendment to Rule 4.21(b)(5)(A)(i) and a nonsubstantive amendment to Rule 4.21 to renumber current Rule 4.21(b)(5)(A)(ii) as new Rule 4.21(b)(5)(A)(iii).

⁷ All non-FLEX Equity Options (including on ETFs) are physically settled. Note all FLEX and non-FLEX Equity Options (including ETFs) are p.m.-settled.

⁸ See proposed Rule 4.21(b)(5)(A)(ii)(a). The Exchange will announce the implementation date of the proposed rule change via Exchange Notice. The Exchange plans to conduct the bi-annual review on January 1 and July 1 of each year. The results of the bi-annual review will be announced via Exchange Notice and any new securities that qualify would

will permit cash settlement as a contract term on no more than 50 underlying ETFs that meet the criteria in Rule 4.21(b)(5)(A)(ii), and that if more than 50 underlying ETFs satisfy the notional value and trading volume requirements, then the Exchange would select the top 50 ETFs that have the highest average daily volume.⁹

Proposed new subparagraph (b) to Rule 4.21(b)(5)(A)(ii) would further provide that if the Exchange determines pursuant to the bi-annual review that an underlying ETF ceases to satisfy the requirements under Rule 4.21(b)(5)(A)(ii), any new position overlying such ETF entered into will be required to have exercise settlement by physical delivery, and any open cash-settled FLEX ETF Option positions may be traded only to close the position.¹⁰

The Exchange believes it is appropriate to introduce cash settlement as an alternative contract term to the select group of ETFs because they are among the most highly liquid and actively traded securities. As described more fully below, the Exchange believes that the deep

be permitted to have cash settlement as a contract term beginning on February 1 and August 1 of each year. If the Exchange initially begins listing cash-settled FLEX Options on a different date (e.g., September 1), it would initially list securities that qualified as of the last bi-annual review (e.g., the one conducted on July 1).

⁹ See proposed Rule 4.21(b)(5)(A)(ii)(a).

¹⁰ See proposed Rule 4.21(b)(5)(A)(ii)(b). A TPH that is acting as a Market Maker may enter into an opening transaction in order to accommodate closing transactions of other market participants in option series that are restricted to closing-only transactions. See Cboe Options Rule 4.4; see also Cboe Options Rule 8.46 (which authorizes the Exchange to impose, from time to time in its discretion, such restrictions on Exchange option transactions or the exercise of option contracts in one or more series of options of any class dealt on the Exchange as it deems advisable in the interests of maintaining a fair and orderly market). Consistent with a Market Maker's duty to maintain fair and orderly markets under Rule 5.51, the Exchange will provide guidance to reflect that a TPH acting as a Market Maker in cash-settled FLEX ETF Options can enter into an opening transaction to facilitate closing only transactions of another market participant in cash-settled FLEX ETF Option series that are restricted to closing-only transactions.

liquidity and robust trading activity in the ETFs identified by the Exchange as meeting the criteria mitigate against historic concerns regarding susceptibility to manipulation.

Characteristics of ETFs

ETFs are funds that have their value derived from assets owned. The net asset value (“NAV”) of an ETF is a daily calculation that is based off the most recent closing prices of the assets in the fund and an actual accounting of the total cash in the fund at the time of calculation. The NAV of an ETF is calculated by taking the sum of the assets in the fund, including any securities and cash, subtracting out any liabilities, and dividing that by the number of shares outstanding.

Additionally, each ETF is subject to a creation and redemption mechanism to ensure the price of the ETF does not fluctuate too far away from its NAV, which mechanisms reduce the potential for manipulative activity. Each business day, ETFs are required to make publicly available a portfolio composition file that describes the makeup of their creation and redemption “baskets” (i.e., a specific list of names and quantities of securities or other assets designed to track the performance of the portfolio as a whole). ETF shares are created when an Authorized Participant, typically a market maker or other large institutional investor, deposits the daily creation basket or cash with the ETF issuer. In return for the creation basket or cash (or both), the ETF issues to the Authorized Participant a “creation unit” that consists of a specified number of ETF shares. For instance, IWM is designed to track the performance of the Russell 2000 Index. An Authorized Participant will purchase all the Russell 2000 constituent securities in the exact same weight as the index prescribes, then deliver those shares to the ETF issuer. In exchange, the ETF issuer gives the Authorized Participant a block of equally valued ETF shares, on a one-for-one fair value basis. This process can also work in reverse. A redemption is achieved when the Authorized

Participant accumulates a sufficient number of shares of the ETF to constitute a creation unit and then exchanges these ETF shares with the ETF issuer, thereby decreasing the supply of ETF shares in the market.

The principal, and perhaps most important, feature of ETFs is their reliance on an “arbitrage function” performed by market participants that influences the supply and demand of ETF shares and, thus, trading prices relative to NAV. As noted above, new ETF shares can be created and existing shares redeemed based on investor demand; thus, ETF supply is open-ended. This arbitrage function helps to keep an ETF’s price in line with the value of its underlying portfolio, i.e., it minimizes deviation from NAV. Generally, in the Exchange’s view, the higher the liquidity and trading volume of an ETF, the more likely the price of the ETF will not deviate from the value of its underlying portfolio, making such ETFs less susceptible to price manipulation.

Trading Data for the ETFs Proposed for Cash Settlement

The Exchange believes that average daily notional value is an appropriate proxy for selecting underlying securities that are not readily susceptible to manipulation for purposes of establishing a settlement price. Average daily notional value considers both the trading activity and the price of an underlying security. As a general matter, the more expensive an underlying security’s price, the less cost-effective manipulation could become. Further, manipulation of the price of a security encounters greater difficulty the more volume that is traded. To calculate average daily notional value (provided in the table below), the Exchange summed the notional value of each trade for each symbol (i.e., the number of shares times the price for each execution in the security) and divided that total by the number of trading days in the six-month period (from January 1, 2023 through June 30, 2023) reviewed by the Exchange.

Further, the Exchange proposes that qualifying ETFs also meet an ADV standard. The purpose for this second criteria is to prevent unusually expensive underlying securities from qualifying under the average daily notional value standard while not being one of the most actively traded securities. The Exchange believes an ADV requirement of 4,680,000 shares a day is appropriate because it represents average trading in the underlying ETF of 200 shares per second. While no security is immune from all manipulation, the Exchange believes that the combination of average daily notional value and ADV as prerequisite requirements would limit cash settlement of FLEX ETF Options to those underlying ETFs that would be less susceptible to manipulation in order to establish a settlement price.

The Exchange believes that the proposed objective criteria would ensure that only the most robustly traded and deeply liquid ETFs would qualify to have cash settlement as a contract term. As provided in the table below, as of June 30, 2023, the Exchange would be able to provide cash settlement as a contract term for FLEX ETF Options on 39 underlying ETFs, as only this group of securities would currently meet the requirement of \$500 Million or more average daily notional value and a minimum ADV of 4,680,000 shares. The table below provides the list of the 39 ETFs that, as of June 30, 2023, would be eligible to have cash settlement as a contract term.

Symbol	Security Name	Average Daily Notional Value (in dollars) (1/1/23 – 6/30/23)	Average Daily Volume (in shares) (1/1/23 – 6/30/23)
AGG	ISHARES TR CORE US AGGBD ET	\$703,126,857	7,116,525
ARKK	ARK ETF TR INNOVATION ETF	\$858,537,852	22,026,750
BIL	SPDR SER TR BLOOMBERG 1-3 MO	\$691,090,219	7,543,846
EEM	ISHARES TR MSCI EMG MKT ETF	\$1,284,326,169	32,458,368
EFA	ISHARES TR MSCI EAFE ETF	\$1,308,724,046	18,457,234
EMB	ISHARES TR JPMORGAN USD EMG	\$559,160,916	6,510,071
EWZ	ISHARES INC MSCI BRAZIL ETF	\$756,467,915	26,179,000
FXI	ISHARES TR CHINA LG-CAP ETF	\$953,344,257	32,659,170

GDX	VANECK ETF TRUST GOLD MINERS ETF	\$717,525,246	22,888,829
GLD	SPDR GOLD TR GOLD SHS	\$1,373,373,829	7,600,698
HYG	ISHARES TR IBOXX HI YD ETF	\$3,038,710,673	40,690,044
IEF	ISHARES TR 7-10 YR TRSY BD	\$833,776,310	8,506,605
IEFA	ISHARES CORE MSCI EAFE ETF	\$640,740,104	9,645,504
IEMG	ISHARES INC CORE MSCI EMKT	\$610,571,206	12,458,329
IWM	ISHARES TR RUSSELL 2000 ETF	\$5,402,906,722	29,985,329
IYR	ISHARES TR U.S. REAL ES ETF	\$575,694,782	6,749,049
JNK	SPDR SER TR BLOOMBERG HIGH Y	\$809,645,750	8,834,914
KRE	SPDR S&P REGIONAL BANKING ETF	\$1,020,754,439	22,996,273
KWEB	KRANESHARES TR CSI CHI INTERNET	\$556,570,098	18,594,683
LQD	ISHARES TR IBOXX INV CP ETF	\$2,209,277,519	20,444,446
QQQ	INVESCO QQQ TR UNIT SER 1	\$17,517,678,522	55,508,283
SMH	VANECK SEMICONDUCTOR ETF	\$954,728,520	4,827,785
SOXL	DIREXION SHS ETF TR DLY SCOND 3XBU	\$1,240,910,219	76,587,443
SOXS	DIREXION SHS ETF TR DLY SEMICNDTR BR	\$832,524,309	45,142,015
SPXL	DIREXION SHS ETF TR DRX S&P500BULL	\$946,357,247	13,134,890
SPY	SPDR S&P 500 ETF TR TR UNIT	\$34,975,824,706	85,701,074
SQQQ	PROSHARES TR ULTRAPRO SHT QQQ	\$4,273,866,273	130,095,374
TLT	ISHARES TR 20 YR TR BD ETF	\$2,246,375,199	21,559,136
TQQQ	PROSHARES TR ULTRAPRO QQQ	\$3,902,736,049	149,675,087
XBI	SPDR SER TR S&P BIOTECH	\$709,508,423	8,539,337
XLE	SELECT SECTOR SPDR TR ENERGY	\$1,648,556,002	19,872,930
XLF	SELECT SECTOR SPDR TR FINANCIAL	\$1,699,571,786	51,002,077
XLI	SELECT SECTOR SPDR TR SBI INT- INDS	\$1,190,848,482	11,870,935
XLK	SELECT SECTOR SPDR TR TECHNOLOGY	\$1,006,555,659	6,839,312
XLP	SELECT SECTOR SPDR TR SBI CONS STPLS	\$855,296,387	11,569,373
XLU	SELECT SECTOR SPDR TR SBI INT- UTILS	\$879,471,277	13,077,264
XLV	SELECT SECTOR SPDR TR SBI HEALTHCARE	\$1,187,391,938	9,085,631
XLY	SELECT SECTOR SPDR TR SBI CONS DISCR	\$742,561,935	5,018,636
XOP	SPDR SER TR S&P OILGAS EXP	\$619,413,460	4,826,441

The Exchange believes that permitting cash settlement as a contract term for FLEX ETF Options for the ETFs in the above table would broaden the base of investors that use FLEX Options to manage their trading and investment risk, including investors that currently trade in the over-the-counter (“OTC”) market for customized options, where settlement restrictions do not apply.

Today, equity options are settled physically at The Options Clearing Corporation (“OCC”), i.e., upon exercise, shares of the underlying security must be assumed or delivered. Physical settlement may possess certain risks with respect to volatility and movement of the underlying security at expiration against which market participants may need to hedge. The Exchange believes cash settlement may be preferable to physical delivery in some circumstances as it does not present the same risk. If an issue with the delivery of the underlying security arises, it may become more expensive (and time consuming) to reverse the delivery because the price of the underlying security would almost certainly have changed. Reversing a cash payment, on the other hand, would not involve any such issue because reversing a cash delivery would simply involve the exchange of cash. Additionally, with physical settlement, market participants that have a need to generate cash would have to sell the underlying security while incurring the costs associated with liquidating their position as well as the risk of an adverse movement in the price of the underlying security.

The Exchange notes that the Securities and Exchange Commission (the “Commission”) has previously approved a rule filing of another exchange that allowed for the trading of cash-settled

options¹¹ and, specifically, cash-settled FLEX ETF Options (which the Exchange proposes to list in the same manner as that exchange).¹²

With respect to position and exercise limits, cash-settled FLEX ETF Options would be subject to the position limits set forth in Rule 8.35. Accordingly, the Exchange proposes new Rule 8.35(c)(1)(B), which would provide that a position in FLEX Equity Options where the underlying security is an ETF and that is settled in cash pursuant to Rule 4.21(b)(5)(A)(ii) would be subject to the position limits set forth in Rule 8.30, and subject to the exercise limits set forth in Rule 8.42.¹³

¹¹ See, e.g., PHLX FX Options traded on Nasdaq PHLX and S&P 500® Index Options traded on Cboe Options Exchange. The Commission approved, on a pilot basis, the listing and trading of RealDay™ Options on the SPDR S&P 500 Trust on the BOX Options Exchange LLC (“BOX”). See Securities Exchange Act Release No. 79936 (February 2, 2017), 82 FR 9886 (February 8, 2017) (“RealDay Pilot Program”). The RealDay Pilot Program was extended until February 2, 2019. See Securities Exchange Act Release No. 82414 (December 28, 2017), 83 FR 577 (January 4, 2018) (SR-BOX-2017-38). The RealDay Pilot Program was never implemented by BOX. See also Securities Exchange Act Release Nos. 56251 (August 14, 2007), 72 FR 46523 (August 20, 2007) (SR-Amex-2004-27) (Order approving listing of cash-settled Fixed Return Options (“FROs”)); and 71957 (April 16, 2014), 79 FR 22563 (April 22, 2014) (SR-NYSEMKT-2014-06) (Order approving name change from FROs to ByRDs and re-launch of these products, with certain modifications).

¹² See Securities Exchange Act Release Nos. 88131 (February 5, 2020), 85 FR 7806 (February 11, 2020) (SR-NYSEAMER-2019-38) (Order Approving a Proposed Rule Change, as Modified by Amendment No. 1, to Allow Certain Flexible Equity Options To Be Cash Settled); and 97231 (March 31, 2023), 88 FR 20587 (April 6, 2023) (SR-NYSEAMER-2023-22) (Notice of Filing and Immediate Effectiveness of Proposed Change to Make a Clarifying Change to the Term Settlement Style Applicable to Flexible Exchange Options).

¹³ The Exchange proposes to add to proposed Rule 8.35(c)(1)(A) a cross-reference to paragraph (d) of Rule 8.35, as Rule 8.35(d) also contains provisions about position limits for FLEX Equity Options that would be exceptions to the statement in Rule 8.35(c) that FLEX Equity Options have no position limits (in addition to the language in proposed Rule 8.35(c)(1)(B)). The Exchange also proposes to add to Rule 8.35(d) a cross-reference to proposed Rule 8.35(c)(1)(B), as the proposed rule adds language regarding aggregation of positions for purposes of position limits, which is currently covered in paragraph (d). Further, the Exchange proposes other nonsubstantive changes to Rule 8.35(c) to add a corresponding change to proposed Rule 8.35(c)(1)(A) and to add paragraph numbering and lettering, add subheadings, and delete certain introductory

The proposed rule further states that positions in such cash-settled FLEX Equity Options shall be aggregated with positions in physically settled options on the same underlying ETF for the purpose of calculating the position limits set forth in Rule 8.30, and the exercise limits set forth in Rule 8.42.¹⁴ Given that each of the underlying ETFs that would currently be eligible to have cash-settlement as a contract term have established position and exercise limits applicable to physically settled options, the Exchange believes it is appropriate for the same position and exercise limits to also apply to cash-settled options. Accordingly, of the 39 underlying securities that would currently be eligible to have cash settlement as a FLEX contract term, 25 would have a position limit of 250,000 contracts pursuant to Rule 8.30, Interpretation and Policy .02.¹⁵ Further, pursuant to Rule 8.30, Interpretation and Policy .07, eight would have a position limit of 500,000 contracts; four (EEM, FXI, IWM, and EFA) would have a position limit of 1,000,000 contracts; one (QQQ) would have a position limit of 1,800,000 contracts; and one (SPY) would have a position limit of 3,600,000.¹⁶

The Exchange understands that cash-settled ETF options are currently traded in the OTC market by a variety of market participants, e.g., hedge funds, proprietary trading firms, and pension

words that are, as a result of the paragraph reorganization, no longer necessary.

¹⁴ See proposed Rule 8.35(c)(1)(B). The aggregation of position and exercise limits would include all positions on physically settled FLEX and non-FLEX options on the same underlying ETFs.

¹⁵ Rule 8.30, Interpretation and Policy .02(e) provides that the position limit shall be 250,000 contracts for options: (i) on an underlying security that had trading volume of at least 100,000,000 shares during the most recent six-month trading period; or (ii) on an underlying security that had trading volume of at least 75,000,000 shares during the most recent six-month trading period and has at least 300,000,000 shares currently outstanding. Twenty-five of the thirty-nine underlying ETFs currently meet the requirements under Interpretation and Policy .02(e).

¹⁶ These were based on position limits as of July 28, 2023. Position limits are available on at [OCC - Position Limits \(theocc.com\)](https://www.theocc.com). Position limits for ETFs are always determined in accordance with the Exchange's Rules regarding position limits.

funds.¹⁷ These options are not fungible with the exchange listed options. The Exchange believes some of these market participants would prefer to trade comparable instruments on an exchange, where they would be cleared and settled through a regulated clearing agency. The Exchange expects that users of these OTC products would be among the primary users of exchange-traded cash-settled FLEX ETF Options. The Exchange also believes that the trading of cash-settled FLEX ETF Options would allow these same market participants to better manage the risk associated with the volatility of underlying equity positions given the enhanced liquidity that an exchange-traded product would bring.

In the Exchange's view, cash-settled FLEX ETF Options traded on the Exchange would have three important advantages over the contracts that are traded in the OTC market. First, as a result of greater standardization of contract terms, exchange-traded contracts should develop more liquidity. Second, counter-party credit risk would be mitigated by the fact that the contracts are issued and guaranteed by OCC. Finally, the price discovery and dissemination provided by the Exchange and its members would lead to more transparent markets. The Exchange believes that its ability to offer cash-settled FLEX ETF Options would aid it in competing with the OTC market and at the same time expand the universe of products available to interested market participants. The Exchange believes that an exchange-traded alternative may provide a useful risk management and trading vehicle for market participants and their customers. Further, the Exchange believes listing cash-settled FLEX ETF Options would provide investors with competition on an exchange platform, as another exchange as received Commission approval to list the same options.¹⁸

¹⁷ As noted above, another option exchange received approval to list certain cash-settled FLEX ETF Options. See supra note 12.

¹⁸ See supra note 12.

The Exchange notes that OCC has received approval from the Commission for rule changes that will accommodate the clearance and settlement of cash-settled ETF Options.¹⁹ The Exchange has also analyzed its capacity and represents that it and The Options Price Reporting Authority (OPRA) have the necessary systems capacity to handle the additional traffic associated with the listing of cash-settled FLEX ETF Options. The Exchange believes any additional traffic that would be generated from the introduction of cash-settled FLEX ETF Options would be manageable. The Exchange expects that Trading Permit Holders (“TPHs”) will not have a capacity issue as a result of this proposed rule change. The Exchange also does not believe this proposed rule change will cause fragmentation of liquidity. The Exchange will monitor the trading volume associated with the additional options series listed as a result of this proposed rule change and the effect (if any) of these additional series on market fragmentation and on the capacity of the Exchange’s automated systems.

The Exchange does not believe that allowing cash settlement as a contract term would render the marketplace for equity options more susceptible to manipulative practices. The Exchange believes that manipulating the settlement price of cash-settled FLEX ETF Options would be difficult based on the size of the market for the underlying ETFs that are the subject of this proposed rule change. The Exchange notes that each underlying ETF in the table above is sufficiently active to alleviate concerns about potential manipulative activity. Further, in the Exchange’s view, the vast liquidity in the 39 underlying ETFs that would currently be eligible to be traded as cash-settled FLEX options under the proposal ensures a multitude of market participants at any given time. Moreover, given the high level of participation among market participants that enter quotes and/or orders in physically settled options on these ETFs, the Exchange believes it

¹⁹ See Securities Exchange Act Release No. 34-94910 (May 13, 2022), 87 FR 30531 (May 19, 2022) (SR-OCC-2022-003).

would be very difficult for a single participant to alter the price of the underlying ETF or options overlying such ETF in any significant way without exposing the would-be manipulator to regulatory scrutiny. The Exchange further believes any attempt to manipulate the price of the underlying ETF or options overlying such ETF would also be cost prohibitive. As a result, the Exchange believes there is significant participation among market participants to prevent manipulation of cash-settled FLEX ETF Options.

Still, the Exchange believes it has an adequate surveillance program in place and intends to apply the same program procedures to cash-settled FLEX ETF Options that it applies to the Exchange's other options products.²⁰ FLEX options products and their respective symbols are integrated into the Exchange's existing surveillance system architecture and are thus subject to the relevant surveillance processes. The Exchange believes that the existing surveillance procedures at the Exchange are capable of properly identifying unusual and/or illegal trading activity, which procedures the Exchange would utilize to surveil for aberrant trading in cash-settled FLEX ETF Options.

With respect to regulatory scrutiny, the Exchange believes its existing surveillance technologies and procedures adequately address potential concerns regarding possible manipulation of the settlement value at or near the close of the market. The Exchange notes that the regulatory program operated by and overseen by the Cboe Global Markets, the Exchange's parent company ("Cboe"), Regulatory Division (which regulates the Exchange and its affiliated national securities exchanges)²¹ includes cross-market surveillance designed to identify manipulative and other

²⁰ For example, the regulatory program for the Exchange includes surveillance designed to identify manipulative and other improper options trading, including, spoofing, marking the close, front running, wash sales, etc.

²¹ Cboe and its affiliated securities exchanges maintain regulatory services agreements with Financial Industry Regulatory Authority, Inc. ("FINRA") whereby FINRA provides

improper trading, including spoofing, algorithm gaming, marking the close and open, as well as more general, abusive behavior related to front running, wash sales, quoting/routing, and Reg SHO violations, that may occur on the Exchange or other markets. These cross-market patterns incorporate relevant data from various markets beyond the Exchange and its affiliates and from markets not affiliated with the Exchange. The Exchange represents that its existing trading surveillances and those of its affiliated markets are adequate to monitor trading in the underlying ETFs and subsequent trading of options on those securities on the Exchange, including cash-settled FLEX ETF Options.²²

Additionally, for options, the Exchange utilizes an array of patterns that monitor manipulation of options, or manipulation of equity securities (regardless of venue) for the purpose of impacting options prices on the Exchange (i.e., mini-manipulation strategies). That surveillance coverage is initiated once options begin trading on the Exchange. Accordingly, the Exchange believes that the cross-market surveillance performed by the Exchange or FINRA, on behalf of the Exchange, coupled with the Cboe Regulatory Division's own monitoring for violative activity on the Exchange comprise a comprehensive surveillance program that is adequate to monitor for manipulation of the underlying ETF and overlying option. Furthermore, the Exchange believes that the existing surveillance procedures at the Exchange are capable of properly identifying unusual and/or illegal trading activity, which the Exchange would utilize to surveil for aberrant trading in cash-settled FLEX ETF Options.

certain regulatory services to the exchanges, including cross-market surveillance, investigation, and enforcement services.

²² Such surveillance procedures generally focus on detecting securities trading subject to opening price manipulation, closing price manipulation, layering, spoofing or other unlawful activity impacting an underlying security, the option, or both. The Exchange has price movement alerts, unusual market activity and order book alerts active for all trading symbols.

In addition to the surveillance procedures and processes described above, improvements in audit trails (i.e., the Consolidated Audit Trail), recordkeeping practices, and inter-exchange cooperation over the last two decades have greatly increased the Exchange’s ability to detect and punish attempted manipulative activities. In addition, the Exchange is a member of the Intermarket Surveillance Group (“ISG”). The ISG members work together to coordinate surveillance and investigative information sharing in the stock and options markets.²³ For surveillance purposes, the Exchange would therefore have access to information regarding trading activity in the pertinent underlying securities.

The proposed rule change is designed to allow investors seeking to effect cash-settled FLEX ETF Options with the opportunity for a different method of settling option contracts at expiration if they choose to do so. As noted above, market participants may choose cash settlement because physical settlement possesses certain risks with respect to volatility and movement of the underlying security at expiration that market participants may need to hedge against. The Exchange believes that offering innovative products flows to the benefit of the investing public. A robust and competitive market requires that exchanges respond to members’ evolving needs by constantly improving their offerings. Such efforts would be stymied if exchanges were prohibited from offering innovative products for reasons that are generally debated in academic literature. The Exchange believes that introducing cash-settled FLEX ETF Options would further broaden the base of investors that use FLEX Options to manage their trading and investment risk, including investors that currently trade in the OTC market for customized options, where settlement restrictions do not apply. The proposed rule change is also designed to encourage market makers to shift liquidity

²³ See, e.g., Cboe Regulatory Circular 20-028, *Establishment of the CMRWG* (April 8, 2020)

from the OTC market onto the Exchange, which, it believes, would enhance the process of price discovery conducted on the Exchange through increased order flow. The Exchange also believes that this may open up cash-settled FLEX ETF Options to more retail investors. The Exchange does not believe that this proposed rule change raises any unique regulatory concerns because existing safeguards — such as position limits (and the aggregation of cash-settled positions with physically-settled positions), exercise limits (and the aggregation of cash-settled positions with physically-settled positions), and reporting requirements — would continue to apply. The Exchange believes the proposed position and exercise limits may further help mitigate the concerns that the limits are designed to address about the potential for manipulation and market disruption in the options and the underlying securities.²⁴

Given the novel characteristics of cash-settled FLEX ETF Options, the Exchange will conduct a review of the trading in cash-settled FLEX ETF Options over an initial five-year period. The Exchange will furnish five reports to the Commission based on this review, the first of which would be provided within 60 days after the first anniversary of the initial listing date of the first cash-settled FLEX ETF Option under the proposed rule and each subsequent annual report to be provided within 60 days after the second, third, fourth and fifth anniversary of such initial listing. At a minimum, each report will provide a comparison between the trading volume of all cash-settled FLEX ETF Options listed under the proposed rule and physically settled options on the same underlying security, the liquidity of the market for such options products and the underlying ETF, and any manipulation concerns arising in connection with the trading of cash-settled FLEX ETF Options under the proposed rule. The Exchange will also provide additional data as requested by the Commission during this five-year period. The reports will also discuss any recommendations

²⁴ See supra note 16.

the Exchange may have for enhancements to the listing standards based on its review. The Exchange believes these reports will allow the Commission and the Exchange to evaluate, among other things, the impact such options have, and any potential adverse effects, on price volatility and the market for the underlying ETFs, the component securities underlying the ETFs, and the options on the same underlying ETFs and make appropriate recommendations, if any, in response to the reports.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to the Exchange and, in particular, the requirements of Section 6(b) of the Act.²⁵ Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)²⁶ 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. Specifically, the Exchange believes that introducing cash-settled FLEX ETF Options will increase order flow to the Exchange, increase the variety of options products available for trading, and provide a valuable tool for investors to manage risk.

The Exchange believes that the proposal to permit cash settlement as a contract term for options on the specified group of equity securities would remove impediments to and perfect the

²⁵ 15 U.S.C. 78f(b).

²⁶ 15 U.S.C. 78f(b)(5).

mechanism of a free and open market as cash-settled FLEX ETF Options would enable market participants to receive cash in lieu of shares of the underlying security, which would, in turn, provide greater opportunities for market participants to manage risk through the use of a cash-settled product to the benefit of investors and the public interest. The Exchange does not believe that allowing cash settlement as a contract term for options on the specified group of equity securities would render the marketplace for equity options more susceptible to manipulative practices. As illustrated in the table above, each of the qualifying underlying securities is actively traded and highly liquid and thus would not be susceptible to manipulation because, over a six-month period, each security had an average daily notional value of at least \$500 million and an ADV of at least 4,680,000 shares, which indicates that there is substantial liquidity present in the trading of these securities, and that there is significant depth and breadth of market participants providing liquidity and of investor interest. The Exchange believes the proposed bi-annual review to determine eligibility for an underlying ETF to have cash settlement as a contract term would remove impediments to and perfect the mechanism of a free and open market as it would permit the Exchange to select only those underlying ETFs that are actively traded and have robust liquidity as each qualifying ETF would be required to meet the average daily notional value and average daily volume requirements, as well as to select the same underlying ETFs on which another exchange may list cash-settled FLEX ETF Options.²⁷

The Exchange believes the proposed change that, for FLEX ETF Options, at least one of exercise style, expiration date, and exercise price must differ from options in the non-FLEX market will provide clarity and eliminate confusion regarding permissible terms of FLEX ETF Options, including the proposed cash-settled FLEX ETF Options.

²⁷ See supra note 12.

The Exchange believes that the data provided by the Exchange supports the supposition that permitting cash settlement as a FLEX term for the 39 underlying ETFs that would currently qualify to have cash settlement as a contract term would broaden the base of investors that use FLEX Options to manage their trading and investment risk, including investors that currently trade in the OTC market for customized options, where settlement restrictions do not apply.

The Exchange believes that the proposal to permit cash settlement for certain FLEX ETF options would remove impediments to and perfect the mechanism of a free and open market because the proposed rule change would provide TPHs with enhanced methods to manage risk by receiving cash if they choose to do so instead of the underlying security. In addition, this proposal would promote just and equitable principles of trade and protect investors and the general public because cash settlement would provide investors with an additional tool to manage their risk. Further, the Exchange notes that other exchanges have previously received approval that allow for the trading of cash-settled options²⁸ and, specifically, cash-settled FLEX ETF Options in an identical manner as the Exchange proposes to list them pursuant to this rule filing.²⁹ The proposed rule change therefore should not raise issues for the Commission that it has not previously addressed.

The proposed rule change to permit cash settlement as a contract term for options on up to 50 ETFs is designed to promote just and equitable principles of trade in that the availability of cash settlement as a contract term would give market participants an alternative to trading similar products in the OTC market. By trading a product in an exchange-traded environment (that is currently traded in the OTC market), the Exchange would be able to compete more effectively

²⁸ See supra note 11.

²⁹ See supra note 12.

with the OTC market. The Exchange believes the proposed rule change is designed to prevent fraudulent and manipulative acts and practices in that it would lead to the migration of options currently trading in the OTC market to trading on the Exchange. Also, any migration to the Exchange from the OTC market would result in increased market transparency. Additionally, the Exchange believes the proposed rule change is designed to remove impediments to and to perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest in that it should create greater trading and hedging opportunities and flexibility. The proposed rule change should also result in enhanced efficiency in initiating and closing out positions and heightened contra-party creditworthiness due to the role of OCC as issuer and guarantor of the proposed cash-settled options. Further, the proposed rule change would result in increased competition by permitting the Exchange to offer products that are currently available for trading only in the OTC market and are approved to trade on another options exchange.

The Exchange believes that establishing position limits for cash-settled FLEX ETF Options to be the same as physically settled options on the same underlying security, and aggregating positions in cash-settled FLEX ETF Options with physically settled options on the same underlying security for purposes of calculating position limits is reasonable and consistent with the Act. By establishing the same position limits for cash-settled FLEX ETF Options as for physically settled options on the same underlying security and, importantly, aggregating such positions, the Exchange believes that the position limit requirements for cash-settled FLEX ETF Options should help to ensure that the trading of cash-settled FLEX ETF Options would not increase the potential for manipulation or market disruption and could help to minimize such

incentives. For the same reasons, the Exchange believes the proposed exercise limits are reasonable and consistent with the Act.

Finally, the Exchange represents that it has an adequate surveillance program in place to detect manipulative trading in cash-settled FLEX ETF Options and the underlying ETFs. Regarding the proposed cash settlement, the Exchange would use the same surveillance procedures currently utilized for the Exchange's other FLEX Options. For surveillance purposes, the Exchange would have access to information regarding trading activity in the pertinent underlying ETFs. The Exchange believes that limiting cash settlement to no more than 50 underlying ETFs (currently, 39 ETFs would be eligible to have cash-settlement as a contract term) would minimize the possibility of manipulation due to the robust liquidity in both the equities and options markets.

As a self-regulatory organization, the Exchange recognizes the importance of surveillance, among other things, to detect and deter fraudulent and manipulative trading activity as well as other violations of Exchange rules and the federal securities laws. As discussed above, the Cboe Regulatory Division has adequate surveillance procedures in place to monitor trading in cash-settled FLEX ETF Options and the underlying securities, including to detect manipulative trading activity in both the options and the underlying ETF.³⁰ The Exchange further notes the liquidity and active markets in the underlying ETFs, and the high number of market participants in both the underlying ETFs and existing options on the ETFs, helps to minimize the possibility of manipulation. The

³⁰ Among other things, the Cboe Regulatory Division's regulatory program include cross-market surveillance designed to identify manipulative and other improper trading, including spoofing, algorithm gaming, marking the close and open, as well as more general abusive behavior related to front running, wash sales, quoting/routing, and Reg SHO violations, that may occur on the Exchange and other markets. Furthermore, the Exchange stated that it has access to information regarding trading activity in the pertinent underlying securities as a member of ISG.

Exchange further notes that under Section 19(g) of the Act, the Exchange, as a self-regulatory organization, is required to enforce compliance by its members and persons associated with its members with the Act, the rules and regulations thereunder, and the rules of the Exchange.³¹ The Exchange believes its surveillance, along with the liquidity criteria and position and exercise limits requirements, are reasonably designed to mitigate manipulation and market disruption concerns and will permit it to enforce compliance with the proposed rules and other Exchange rules in accordance with Section 19(g) of the Act. The Exchange performs ongoing evaluations of its surveillance program to ensure its continued effectiveness and will continue to review its surveillance procedures on an ongoing basis and make any necessary enhancements and/or modifications that may be needed for the cash settlement of FLEX ETF Options.

Additionally, the Exchange will monitor any effect additional options series listed under the proposed rule change will have on market fragmentation and the capacity of the Exchange's automated systems. The Exchange will take prompt action, including timely communication with the Commission and with other self-regulatory organizations responsible for oversight of trading in options, the underlying ETFs, and the ETFs' component securities, should any unanticipated adverse market effects develop.

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 all TPHs that are registered as FLEX Traders in accordance with the Exchange's Rules will be able

³¹ 15 U.S.C. 78s(g).

to trade cash-settled FLEX ETF Options in the same manner. This includes the proposed change that, for FLEX ETF Options, at least one of exercise style, expiration date, and exercise price must differ from options in the non-FLEX market, which will provide clarity and eliminate confusion regarding permissible terms of FLEX ETF Options, including the proposed cash-settled FLEX ETF Options, with which all FLEX Traders must comply. Additionally, positions in cash-settled FLEX ETF Options of all FLEX Traders will be subject to the same position limits, and such positions will be aggregated with positions in physically settled options on the same underlying in the same manner.

The Exchange does not believe that 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, as the proposal is designed to increase competition for order flow on the Exchange in a manner that is beneficial to investors because it is designed to provide investors seeking to transact in FLEX ETF Options with the opportunity for an alternative method of settling their option contracts at expiration. The Exchange believes the proposed rule change will encourage competition, as it may broaden the base of investors that use FLEX Options to manage their trading and investment risk, including investors that currently trade in the OTC market for customized options, where settlement restrictions do not apply. The proposed rule change would give market participants an alternative to trading similar products in the OTC market. By trading a product in an exchange-traded environment (that is currently traded in the OTC market), the Exchange would be able to compete more effectively with the OTC market. The Exchange believes the proposed rule change may increase competition as it may lead to the migration of options currently trading in the OTC market to trading on the Exchange. Also, any migration to

the Exchange from the OTC market would result in increased market transparency and thus increased price competition.

The Exchange further notes that it operates in a highly competitive market in which market participants can readily direct order flow to competing venues who offer similar functionality. The Exchange believes the proposed rule change encourages competition amongst market participants to provide tailored cash-settled FLEX ETF Option contracts, as another exchange has received approval to list these contracts (subject to the same position and exercise limits as proposed).³² Therefore, the Exchange believes the proposed rule change will enhance intermarket competition by providing investors with a choice of exchange venues on which to trade cash-settled FLEX ETF Options.

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act³³ and Rule 19b-4(f)(6)(iii) thereunder.³⁴

³² See supra note 12.

³³ 15 U.S.C. 78s(b)(3)(A).

³⁴ 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

A proposed rule change filed under Rule 19b-4(f)(6)³⁵ normally does not become operative prior to 30 days after the date of filing. However, pursuant to Rule 19b-4(f)(6)(iii),³⁶ the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has asked the Commission to waive the 30-day operative delay so that the proposed rule change may become operative upon filing. The Exchange states, among other things, that waiver of the 30-day operative delay will protect investors by providing them with an immediate choice and an additional venue where they can trade cash-settled FLEX ETF Options. The Commission approved a substantially similar proposal by another exchange that was subject to notice and comment and found consistent with the Act.³⁷ For these reasons, and because the proposed rule change does not raise any novel regulatory issues that have not been addressed, the Commission believes waiving the 30-day operative delay is consistent with the protection of investors and the public interest. Therefore, the Commission hereby waives the operative delay and designates the proposal operative upon filing.³⁸

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the

³⁵ 17 CFR 240.19b-4(f)(6).

³⁶ 17 CFR 240.19b-4(f)(6)(iii).

³⁷ See supra note 12.

³⁸ For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

Commission shall institute proceedings to determine whether the proposed rule should be approved or 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 (<https://www.sec.gov/rules/sro.shtml>); or
- Send an email to rule-comments@sec.gov. Please include file number SR-CBOE-2023-036 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 number SR-CBOE-2023-036. This file number should be included on the subject line if email 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 (<https://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 a.m. and 3

p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. Do not include personal identifiable information in submissions; you should submit only information that you wish to make available publicly. We may redact in part or withhold entirely from publication submitted material that is obscene or subject to copyright protection. All submissions should refer to file number SR-CBOE-2023-036 and should be submitted on or before [INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁹

Sherry R. Haywood,

Assistant Secretary.

³⁹ 17 CFR 200.30-3(a)(12).