

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-87311; File No. SR-CBOE-2019-049)

October 15, 2019

Self-Regulatory Organizations; Cboe Exchange, Inc.; Notice of Filing of Amendment No. 2 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment Nos. 1 and 2, to Make Permanent Certain Options Market Rules That Are Linked to the Equity Market Plan to Address Extraordinary Market Volatility

I. Introduction

On August 21, 2019, Cboe Exchange, Inc. (the “Exchange” or “Cboe Options”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to make permanent certain options market rules that are linked to the equity market Plan to Address Extraordinary Market Volatility (the “Plan”). The proposed rule change was published for comment in the Federal Register on August 29, 2019.<sup>3</sup> On October 10, 2019, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>4</sup> On October 11, 2019, the Exchange filed Amendment No. 2 to the proposed rule change, which amended and superseded the proposed rule change, as modified by Amendment No. 1.<sup>5</sup> On October 11, 2019, pursuant to

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 86744 (August 23, 2019), 84 FR 45565 (“Notice”).

<sup>4</sup> In Amendment No. 1, the Exchange revised the proposed rule text to reflect rule numbering and organizational changes enacted by separate proposed rule changes that became effective while the instant proposal was pending before the Commission. Because Amendment No. 1 is a technical amendment that does not materially alter the substance of the proposed rule change or raise unique or novel regulatory issues, it is not subject to notice and comment. Amendment No. 1 to the proposed rule change is available at: <https://www.sec.gov/comments/sr-cboe-2019-049/srcboe2019049-6279378-193288.pdf>.

Section 19(b)(2) of the Act,<sup>6</sup> 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 approve or disapprove the proposed rule change.<sup>7</sup> The Commission received no comment letters on the proposed rule change. This order approves the proposed rule change, as modified by Amendment Nos. 1 and 2, on an accelerated basis.

## II. Description of the Proposal

The Exchange proposes to make permanent certain options market rules in connection with the Plan. In an attempt to address extraordinary market volatility in NMS stocks, the national securities exchanges and the Financial Industry Regulatory Authority, Inc. adopted the Plan pursuant to Rule 608 of Regulation NMS under the Act.<sup>8</sup> Following the initial adoption of the Plan, the Exchange adopted and amended current Rule 5.21, Rule 5.22<sup>9</sup> and Interpretation and Policy .01 to Rule 6.5 to address certain aspects of the options market that it believed may be impacted by the operation of the Plan, and implemented such rules on a pilot basis that has

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<sup>5</sup> In Amendment No. 2, the Exchange revised the proposal to remove the aspect of the proposed rule change that would have permitted current Rule 5.22 – relating to market-wide trading halts due to extraordinary market volatility – to operate on a permanent basis. In Amendment No. 2, the Exchange notes that it intends to submit a separate rule filing proposing to continue to allow Rule 5.22 to operate on a pilot basis. Amendment No. 2 to the proposed rule change is available at: <https://www.sec.gov/comments/sr-cboe-2019-049/srcboe2019049-6285845-193338.pdf>.

<sup>6</sup> 15 U.S.C. 78s(b)(2).

<sup>7</sup> See Securities Exchange Act Release No. 87291. The Commission extended the date by which the Commission shall approve or disapprove the proposed rule change to October 18, 2019.

<sup>8</sup> See Securities Exchange Act Release Nos. 64547 (May 25, 2011), 76 FR 31647 (June 1, 2011) and 67091 (May 31, 2012), 77 FR 33498 (June 6, 2012) (order approving the initial Plan, as amended, on a pilot basis).

<sup>9</sup> The Exchange has determined not to propose to make the provisions in Rule 5.22 permanent at this time. See supra note 5.

coincided with the pilot period for the Plan. These rules are scheduled to expire on October 18, 2019.<sup>10</sup>

In order to codify changes to its rules in connection with the Plan, the Exchange adopted Rule 5.21, which essentially serves as a roadmap for the Exchange's universal changes due to the implementation of the Plan.<sup>11</sup> The Exchange also amended Rule 6.5 to modify its obvious and catastrophic error rules in connection with the implementation of the Plan.<sup>12</sup> After the Plan was approved on a permanent basis, the pilot periods in Rules 5.21, 5.22 and 6.5 were extended until the close of business on October 18, 2019.<sup>13</sup> The Exchange now proposes to make these pilot periods permanent. The Exchange is not proposing any additional or substantive changes to Rules 5.21 or 6.5.<sup>14</sup> At this time, the Exchange is not proposing to make the pilot period in Rule 5.22 permanent.<sup>15</sup>

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<sup>10</sup> See Securities Exchange Act Release No. 69328 (April 5, 2013), 78 FR 21642 (April 11, 2013) (SR-CBOE-2013-030) ("Options Pilot Approval") (order approving certain options rule changes to coincide with the pilot period for the Plan, including Rule 5.21). See also Amendment No. 1, supra note 4 (describing the relocation of these rules to their current location in the Cboe Options rulebook).

<sup>11</sup> See Options Pilot Approval, supra note 10, at 21643. Specifically, Rule 5.21 includes rule changes in connection with special handling for market orders, market-on-close orders, stop orders, and stock-option orders; certain electronic order handling features in a limit up-limit down state; the obvious error rules; and market-maker to quoting requirements during a limit up-limit down state.

<sup>12</sup> See id. at 21645. The amendments to Rule 6.5 were originally adopted on a one-year pilot basis, which was later extended to coincide with the pilot period for the Plan. See Securities Exchange Act Release No. 76223 (October 22, 2015), 80 FR 66102 (October 28, 2015) (SR-CBOE-2015-097).

<sup>13</sup> See Securities Exchange Act Release Nos. 85623 (April 11, 2019), 84 FR 16086 (April 17, 2019) (order approving Amendment No. 18 to the Plan, which, among other things, allowed the Plan to continue to operate on a permanent basis) and 85616 (April 11, 2019), 84 FR 16093 (April 17, 2019) (SR-CBOE-2019-020) (extending the pilot periods in Rules 5.21 and 6.5 to October 18, 2019).

<sup>14</sup> According to the Exchange, it expects the other national securities exchanges to also file similar proposals to make their respective pilot programs permanent. See Notice, supra

Interpretation and Policy .01 to Rule 6.5 currently provides that options transactions executed while the underlying security was in a limit or straddle state (as defined in the Plan) will not be subject to review as an obvious or catastrophic error during a pilot period that expires on October 18, 2019 (“Obvious Error Pilot”).<sup>16</sup> A limit or straddle state occurs when at least one side of the National Best Bid (“NBB”) or National Best Offer (“NBO”) and, together with the NBB, the “NBBO”) is priced at a non-tradable level.<sup>17</sup> Specifically, a straddle state exists when the NBB is below the lower price band while the NBO is within the price band or when the NBO is above the upper price band and the NBB is within the band.<sup>18</sup> A limit state occurs when the NBO equals the lower price band (without crossing the NBB) or the NBB equals the upper price band (without crossing the NBO).<sup>19</sup>

Pursuant to Rule 6.5, the determination of the theoretical price of an option, which is used to determine whether to adjust or nullify an options transaction subject to obvious or catastrophic error review, generally references the NBB (for erroneous sell transactions) or NBO (for erroneous buy transactions) just prior to the trade in question. The Exchange states that this process is not reliable when at least one side of the NBBO is priced at a non-tradeable level, as is the case during

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note 3, at 45566.

<sup>15</sup> See supra note 5.

<sup>16</sup> Such transactions may still be reviewed on an Exchange official’s own motion pursuant to Rule 6.5(c)(3), or adjusted or nullified pursuant to Rule 6.5(e)-(j) and Interpretation and Policy .05. See Interpretation and Policy .01 to Rule 6.5.

<sup>17</sup> See Notice, supra note 3, at 45565. Pursuant to the Plan, each NMS stock is subject to a lower price band and a higher price band, designed to prevent trades in individual NMS stocks from occurring outside of the specified price bands. See Options Pilot Approval, supra note 10, at 21642.

<sup>18</sup> See Notice, supra note 3, at 45565.

<sup>19</sup> See id.

limit and straddle states.<sup>20</sup> According to the Exchange, when an underlying security is in a limit or straddle state, there will not be a reliable price for the security to serve as a benchmark for the price of the option and, therefore, the application of the obvious and catastrophic error rules would be impracticable given the potential for the lack of a reliable NBBO in the options market during such limit or straddle state.<sup>21</sup>

During the course of the Obvious Error Pilot, the Exchange has provided, to the Commission and the public, data for each limit and straddle state in optionable stocks that had at least one trade on the Exchange.<sup>22</sup> In addition, the Exchange has provided, to the Commission and the public, assessments relating to the impact of the operation of the obvious error rules during limit and straddle states, including: (1) an evaluation of the statistical and economic impact of limit and straddle states on liquidity and market quality in the options markets; and (2) an assessment of whether the lack of obvious error rules in effect during the limit and straddle states are problematic. The Exchange states that, during its most recent review period, the Exchange did not receive any obvious error review requests for limit-up-limit down trades, and

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<sup>20</sup> See id.

<sup>21</sup> See id.

<sup>22</sup> See Cboe Global Markets, LULD Limit and Straddle Reports, available at [http://markets.cboe.com/us/options/market\\_statistics/luld\\_reports/?mkt=opt](http://markets.cboe.com/us/options/market_statistics/luld_reports/?mkt=opt). For each trade on the Exchange, the Exchange has provided: (a) the stock symbol, the option symbol, the time at the start of the limit or straddle state, and an indicator for whether it is a limit or straddle state; and (b) the executed volume, the time-weighted quoted bid-ask spread, the time-weighted average quoted depth at the bid, the time-weighted average quoted depth at the offer, the high execution price, the low execution price, the number of trades for which a request for review for error was received during limit and straddle states, and an indicator variable for whether those options outlined above have a price change exceeding 30% during the underlying stock's limit or straddle state compared to the last available option price as reported by OPRA before the start of the limit or straddle state.

limit up-limit down trade volume accounted for nominal overall trade volume.<sup>23</sup> Accordingly, and based on the data made available to the Commission and the public during the pilot period, the Exchange believes that the Obvious Error Pilot does not negatively impact market quality during normal market conditions.<sup>24</sup> The Exchange also concluded that there has been insufficient data to assess whether a lack of obvious error rules is problematic.<sup>25</sup> However, the Exchange believes the continuation of Interpretation and Policy .01 to Rule 6.5 would protect against any unanticipated consequences and add certainty in the options markets during a limit or straddle state.<sup>26</sup>

### III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change, as modified by Amendments No. 1 and 2, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>27</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>28</sup> which requires, among other things, that the rules of a national securities 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 facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and

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<sup>23</sup> See Notice, supra note 3, at 45566 n.9.

<sup>24</sup> See id. at 45566.

<sup>25</sup> See id.

<sup>26</sup> See id.

<sup>27</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>28</sup> 15 U.S.C. 78f(b)(5).

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

In the Options Pilot Approval, the Commission noted the potential inequity of nullifying or adjusting executions occurring during limit or straddle states due to the lack of a reliable NBBO.<sup>29</sup> At the same time, the Commission expressed concern about the potential impact on investors during limit and straddle states without the protections of the obvious or catastrophic error rules.<sup>30</sup> However, in the same order, the Commission also highlighted certain aspects of the Exchange's proposal that could help mitigate those concerns. Specifically, the Exchange stated that there are additional measures in place designed to protect investors, despite the removal of obvious and catastrophic error protection during limit and straddle states.<sup>31</sup> For example, the Exchange stated that by rejecting market orders and not triggering stop orders, only those orders with a limit price will be executed during a limit or straddle state.<sup>32</sup> Additionally, the Exchange noted the existence of Rule 15c3-5 under the Act,<sup>33</sup> requiring broker-dealers to have controls and procedures in place that are reasonably designed to prevent the entry of erroneous orders.<sup>34</sup> Further, the Commission stressed the importance of placing the proposal on a pilot and requesting data to allow the Commission to further evaluate the effect of the proposal prior to any determination to make such changes permanent.<sup>35</sup>

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<sup>29</sup> See Options Pilot Approval, supra note 10, at 21645, 21647.

<sup>30</sup> See id. at 21647.

<sup>31</sup> See id.

<sup>32</sup> See id. See also Rule 5.32(c)(5).

<sup>33</sup> 17 CFR 240.15c3-5.

<sup>34</sup> See Options Pilot Approval, supra note 10, at 21647.

<sup>35</sup> See id. at 21647-48.

Under the terms of the Options Pilot Approval, the Exchange provided the Commission and the public with data and assessments relating to the impact of the operation of the obvious and catastrophic error rules during limit and straddle states.<sup>36</sup> The Commission notes that, as described above, the Exchange stated that it did not receive any obvious error review requests for limit up-limit down trades during its most recent review period.<sup>37</sup> Accordingly, based on the data from the Exchange and in light of the additional measures in place designed to protect investors, despite the removal of obvious and catastrophic error protection during limit and straddle states, the Commission believes it is appropriate to permit the Obvious Error Pilot to operate on a permanent basis.

#### IV. Solicitation of Comments on Amendment No. 2 to the Proposed Rule Change

Interested persons are invited to submit written data, views, and arguments concerning whether Amendment No. 2 is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2019-049 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.

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<sup>36</sup> See supra note 22.

<sup>37</sup> See Notice, supra note 3, at 45566 n.9.



All submissions should refer to File Number SR-CBOE-2019-049. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, 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 Number SR-CBOE-2019-049, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Accelerated Approval of Proposed Rule Change, as Modified by Amendment Nos. 1 and 2

The Commission finds good cause to approve the proposed rule change, as modified by Amendment Nos. 1 and 2, prior to the thirtieth day after the date of publication of notice of the filing of Amendment No. 2 in the Federal Register. As discussed above, in Amendment No. 2, the Exchange revised the proposal to remove the aspect of the proposed rule change that would permit current Rule 5.22 to operate on a permanent basis. The Commission believes that Amendment No. 2 does not raise any novel regulatory issues. Instead, it removes one aspect of

the proposed rule change that does not alter remaining aspects of the proposal, which was subject to a full notice and comment period during which no comments were received. The Commission also notes that, according to the Exchange, it intends to submit a separate rule filing proposing to continue to allow Rule 5.22 to operate on a pilot basis.<sup>38</sup> Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act,<sup>39</sup> to approve the proposed rule change, as modified by Amendment Nos. 1 and 2, on an accelerated basis.

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>40</sup> that the proposed rule change (SR-CBOE-2019-049), as modified by Amendment Nos. 1 and 2, be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>41</sup>

Jill M. Peterson  
Assistant Secretary

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<sup>38</sup> See Amendment No. 2, supra note 5.

<sup>39</sup> 15 U.S.C. 78s(b)(2).

<sup>40</sup> Id.

<sup>41</sup> 17 CFR 200.30-3(a)(12).