

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-90204; File No. SR-CBOE-2020-034)

October 15, 2020

Self-Regulatory Organizations; Cboe Exchange, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Authorize for Trading Flexible Exchange Options on Full-Value Indexes with a Contract Multiplier of One

On June 30, 2020, Cboe Exchange, Inc. (“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 authorize for trading flexible exchange options (“FLEX Options”) on full-value indexes with a contract multiplier of one. The proposed rule change was published for comment in the Federal Register on July 20, 2020.³ On September 2, 2020, 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 This order institutes proceedings under Section

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 89308 (July 14, 2020), 85 FR 43923 (“Notice”). Comments received on the proposed rule change are available on the Commission’s website at: <https://www.sec.gov/comments/sr-cboe-2020-034/srcboe2020034.htm>.

⁴ 15 U.S.C. 78s(b)(2).

⁵ See Securities Exchange Act Release No. 89743, 85 FR 55717 (September 9, 2020). The Commission designated October 18, 2020, as the date by which the Commission shall approve or disapprove, or institute proceedings to determine whether to disapprove, the proposed rule change.

19(b)(2)(B) of the Exchange Act⁶ to determine whether to approve or disapprove the proposed rule change.

I. Description of the Proposal and Comment Received⁷

The Exchange has proposed to amend its rules to authorize for trading on the Exchange FLEX Options on full-value indexes (“FLEX Index Options”) with a contract multiplier of one. Currently, CBOE Rule 4.21(b)(1) states that the index multiplier for FLEX Index Options is 100. The Exchange proposes to provide that, in addition to the current index multiplier of 100, the index multiplier for FLEX Index Options on full-value indexes may also be one.

The Exchange’s rules provide that, when submitting a FLEX Order, the submitting FLEX Trader⁸ must include all required terms of a FLEX Option series,⁹ including the underlying equity security or index (i.e., the FLEX Option class) on the FLEX Order. The proposed rule change would amend Rule 4.21(b)(1) to state that if a FLEX Trader specifies a full-value index on a FLEX Order, the FLEX Trader must also include whether the index option has an index multiplier of 100 or 1 when identifying the class of FLEX Order. In the proposal, the Exchange stated that each FLEX Index Option series in a FLEX Index Option class with a multiplier of one

⁶ 15 U.S.C. 78s(b)(2)(B).

⁷ For a complete description of the Exchange’s proposal, see the Notice, supra note 3.

⁸ A “FLEX Trader” is a Trading Permit Holder the Exchange has approved to trade FLEX Options on the Exchange.

⁹ These terms include, in addition to the underlying equity security or index, the type of options (put or call), exercise style, expiration date, settlement type, and exercise price. See Rule 4.21(b). A “FLEX Order” is an order submitted in FLEX Options. The submission of a FLEX Order makes the FLEX Option series in that order eligible for trading. See Rule 5.72(b).

will include the same flexible terms as any other FLEX Option series, including strike price, settlement, expiration date, and exercise style as required by Rule 4.21(b).¹⁰

The Exchange's rules permit trading in a put or call FLEX Option series only if it does not have the same exercise style, same expiration date, and same exercise price as a non-FLEX option series on the same underlying security or index that is already available for trading.¹¹ Rule 1.1 defines the term "series" as all option contracts of the same class that are the same type of option and have the same exercise price and expiration date. The Exchange stated that it therefore believes that a FLEX Option series in one class may have the same exercise style, expiration date, settlement, and exercise price as a non-FLEX option series in a different class, even if they are on the same underlying security or index. The Exchange stated that it believes, for example, pursuant to the proposed rule change, a FLEX Option series overlying the S&P 500 with a multiplier of one may have the same exercise style, expiration date, settlement, and exercise price as a non-FLEX option series overlying the S&P 500 with a multiplier of 100, as they are series in different classes.

The Exchange represented that FLEX Index Options with a multiplier of one will be traded in the same manner as all other FLEX Options pursuant to Chapter 5, Section F of the Exchange's rules. The proposed rule change would amend Rule 4.21(b)(6) to state that the

¹⁰ The Exchange stated that because these are the terms designated by the Commission as those that constitute standardized options, therefore, the Exchange believes the proposed rule change is consistent with Section 9(b) of the Exchange Act. See Securities Exchange Act Release No. 31910 (February 23, 1993), 58 FR 12056 (March 2, 1993) (Order Designating FLEX Options as Standardized Options under Rule 9b-1 of the Exchange Act) ("FLEX Rule 9b-1 Order").

¹¹ See Rule 4.21(a)(1). Non-FLEX options are standardized options traded on CBOE's non-FLEX options market. All terms of non-FLEX options such as strike prices, exercise types, expiration dates, and settlement types are the same and standardized for all market participants trading non-FLEX options. This is in contrast to the Exchange's FLEX Options market where such terms can be "flexed" by market participants.

exercise price for a FLEX Index Option series in a class with a multiplier of one is set at the same level as the exercise price for a FLEX Index Option series in a class with a multiplier of 100. The proposed rule change also would add to Rule 5.3(e)(3) that FLEX Index Options with a multiplier of one must be expressed in (a) U.S. dollars and decimals if the exercise price for the FLEX Option series is a fixed price, or (b) a percentage, if the exercise price for the FLEX Option series is a percentage of the closing value of the underlying equity security or index on the trade date, per 1/100th unit. In addition, the proposed rule change would state that the Exchange's system rounds bids and offers of FLEX Options to the nearest minimum increment following application of the designated percentage to the closing value of the underlying security or index. The Exchange stated that it believes that this is consistent with current functionality and is merely a clarification in the Exchange's rules.

The Exchange stated that it believes a FLEX Option position with a multiplier of one would not be fungible with any non-FLEX index option. Pursuant to Rule 4.22(a), a FLEX Option position becomes fungible with a non-FLEX option that becomes listed with identical terms. The Exchange stated that it does not list for trading any non-FLEX index option class with a multiplier of one, and that, therefore, in its view, no FLEX Index Option series with a multiplier of 100 could be identical to, and fungible with, any non-FLEX option pursuant to Rule 4.22(a) despite the fact that all the other terms of the FLEX Index Option could be identical to a non-FLEX index option. The Exchange stated that if it determines to list non-FLEX index options with a one multiplier in the future, then a FLEX Index Option with a multiplier of one would become fungible with any non-FLEX index option with a multiplier of one with the same terms pursuant to Rule 4.22(a).

The proposed rule change would amend Rule 8.35(a) regarding position limits for FLEX Options to describe how FLEX Index Options with a multiplier of one will be counted for purposes of determining compliance with position limits. Because 100 FLEX Index Options with a multiplier of one are equivalent to one FLEX Index Option with a multiplier of 100 overlying the same index due to the difference in contract multipliers, proposed Rule 8.35(a)(7) states that for purposes of determining compliance with the position limits under Rule 8.35, 100 FLEX Index Option contracts with a multiplier of one equal one FLEX Index Option contract with a multiplier of 100 with the same underlying index.¹² The Exchange stated that it believes that this is consistent with the current treatment of other reduced-value FLEX Index Options with respect to position limits. The proposed rule change also would amend Rule 8.42 to make a corresponding statement regarding the application of exercise limits to FLEX Index Options with a multiplier of one. The Exchange stated that the margin requirements set forth in Chapter 10 of the Exchange's rules would apply to FLEX Index Options with a multiplier of one (as they currently do to all FLEX Options).¹³

The Exchange stated that it believes that permitting investors to trade FLEX Index Option contracts on full-value indexes with an index multiplier of one will provide investors with additional granularity in the prices at which they may execute and exercise their FLEX Options

¹² According to the Exchange, the proposed rule change would make a corresponding change to Rule 8.35(b) to clarify that, like reduced-value FLEX contracts, FLEX Index Option contracts with a multiplier of one will be aggregated with full-value contracts and counted by the amount by which they equal a full-value contract for purposes of the reporting obligation in that provision (i.e., 100 FLEX Index Options with a multiplier of one will equal one FLEX Index Option contract with a multiplier of 100 overlying the same index).

¹³ The Exchange stated that, pursuant to Rule 8.43(j), FLEX Index Options with a multiplier of one will be aggregated with non-FLEX index options on the same underlying index in the same manner as all other FLEX Index Options.

on the Exchange, and thus provide investors with an additional tool to manage the positions and associated risk in their portfolios based on notional value, which currently may equal a fraction of a standard contract.

The Exchange represented that, with regard to the impact of this proposal on system capacity, the Exchange has analyzed its capacity and represents that it and the Options Price Reporting Authority have the necessary systems capacity to handle the potential additional traffic associated with the listing and trading of FLEX Index Options with a multiplier of one. The Exchange also stated that it understands that the Options Clearing Corporation will be able to accommodate the listing and trading of FLEX Index Options with a multiplier of one. The Exchange stated that, to reduce any potential confusion, FLEX Index Options with a multiplier of one would be listed with different trading symbols than FLEX Index Options with a multiplier of 100.

To date the Commission has received one comment letter, which supports the proposed rule change.¹⁴ The commenter stated that, as a customer of CBOE, the proposal would “dramatically increase the ease of use FLEX options” in its hedging process.¹⁵

II. Proceedings to Determine Whether to Approve or Disapprove SR-CBOE-2020-034 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act¹⁶ 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, as discussed below. Institution of proceedings

¹⁴ See letter from Joyana Pilquist, CFA, dated August 24, 2020.

¹⁵ See id.

¹⁶ 15 U.S.C. 78s(b)(2)(B).

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 proposal.

Pursuant to Section 19(b)(2)(B) of the Exchange Act,¹⁷ the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of the proposed rule change's consistency with the Exchange Act, and, in particular, with Section 6(b)(5) of the Exchange Act, 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 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.¹⁸

The proposal would permit the trading of FLEX Index Options with a contract multiplier of one, which could have the exact same, or similar, terms as non-FLEX options¹⁹ on the same index with a multiplier of 100.²⁰ The trading of FLEX Index Options with a contract multiplier of one under the proposal presents issues related to price protection in currently-existing non-FLEX index options on the same underlying index. Specifically, permitting two options with different contract multipliers on the same underlying interest could have the effect of allowing FLEX Options with a multiplier of one to gain priority over customer orders on the book for the

¹⁷ Id.

¹⁸ 15 U.S.C. 78f(b)(5).

¹⁹ See supra note 11.

²⁰ Under the proposal, 100 FLEX Index Options with a multiplier of one would be economically equivalent to one non-FLEX index option with the same exact terms.

similar non-FLEX index options overlying the same index and also allow bypassing or trading through the national best bid or offer (“NBBO”) in non-FLEX index options. Furthermore, the proposal could lead to market fragmentation by allowing FLEX Index Options to trade with a multiplier of one and index options on the same index to trade in the non-FLEX market with a multiplier of 100. Accordingly, the Commission believes there are questions as to whether the proposal is consistent with Section 6(b)(5) of the Exchange Act and the requirements that the rules of the exchange be designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, and in general, to protect investors and the public interest, and whether the proposal is consistent with the maintenance of fair and orderly markets under the Exchange Act.

The FLEX Rule 9b-1 Order deemed FLEX Options to be standardized options for purposes of the options disclosure framework established under Exchange Act Rule 9b-1, which applies solely to standardized options.²¹ The FLEX Rule 9b-1 Order specifically discussed the ability to flex strike prices, settlement, expiration dates, and exercise style, and states that all of the other terms of FLEX Options are standardized.²² In addition, the Original FLEX Order specifically stated that the index multiplier, among other terms, is the same for FLEX as for non-FLEX index options.²³ Accordingly, the Commission believes there are questions as to whether

²¹ See FLEX Rule 9b-1 Order, supra note 10.

²² See id.

²³ See Securities Exchange Act Release No. 31920 (February 24, 1993), 58 FR 12280 at 12282 (March 3, 1993) (original order approving a CBOE proposal to list and trade FLEX Options on the S&P 100 and 500 Index options (“Original FLEX Order”). The Original FLEX Order stated, among other things, that except for flexing certain terms different from a standardized option (i.e., (1) strike prices; (2) exercise types; (3) expiration date; and (4) form of settlement), “[o]ther terms, such as the level of the index multiplier and the nature of the rights and obligations FLEX Option purchasers and sellers, are the same for FLEX as for non-FLEX index options.” The Commission notes

the Exchange’s proposal is consistent with the FLEX Rule 9b-1 Order and Original FLEX Order and the policies underlying those orders, and whether the proposal is consistent with Section 6(b)(5) of the Exchange Act.

The Commission notes that, under the Commission’s Rules of Practice, the “burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations thereunder...is on the self-regulatory organization [“SRO”] that proposed the rule change.²⁴ The description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding,²⁵ and any failure of an SRO to provide this information may result in the Commission not having sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Exchange Act and the applicable rule and regulations.²⁶

For these reasons, the Commission believes it is appropriate to institute proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act²⁷ to determine whether the proposal should be approved or disapproved.

III. 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

that the Exchange does not currently allow trading of options with a multiplier of one on either FLEX or non-FLEX index options.

²⁴ Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3).

²⁵ See id.

²⁶ See id.

²⁷ 15 U.S.C. 78s(b)(2)(B).

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 Section 6(b)(5) 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 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, which are set forth in the Notice,²⁹ 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

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).

²⁹ See supra note 3.

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-CBOE-2020-034 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-2020-034. 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-2020-034 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.³⁰

J. Matthew DeLesDernier
Assistant Secretary

³⁰ 17 CFR 200.30-3(a)(57).