

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-93655; File No. SR-CBOE-2021-046)

November 23, 2021

Self-Regulatory Organizations; Cboe Exchange, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend Cboe Rule 5.4 and Make Corresponding Changes to Other Rules

I. Introduction

On August 6, 2021, 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”)¹ and Rule 19b-4 thereunder,² a proposed rule change to allow all complex orders to be quoted and executed in \$0.01 increments.³ The proposed rule change was published for comment in the Federal Register on August 25, 2021.⁴ The

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The term “complex order” means an order involving the concurrent execution of two or more different series in the same underlying security or index (the “legs” or “components” of the complex order), for the same account, occurring at or near the same time and for the purpose of executing a particular investment strategy with no more than the applicable number of legs (which number the Exchange determines on a class-by-class basis). The Exchange determines in which classes complex orders are eligible for processing. Unless the context otherwise requires, the term complex order includes stock-option orders and security future-option orders. For purposes of Rules 5.33 and 5.85(b)(1), the term “complex order” means a complex order with any ratio equal to or greater than one-to-three (.333) and less than or equal to three-to-one (3.00), an Index Combo order, a stock-option order, or a security future-option order. For the purpose of applying these ratios to complex orders comprised of legs for both mini-options and standard options, ten mini-option contracts represent one standard option contract. For the purpose of applying these ratios to complex orders comprised of legs for both micro-options and standard options, 100 micro-option contracts represent one standard option contract. See Cboe Rule 1.1.

⁴ See Securities Exchange Act Release No. 92709 (August 19, 2021), 86 FR 47529 (“Notice”).

Commission received two comment letters regarding the proposal.⁵ Cboe responded to the comments on September 23, 2021.⁶ On September 28, 2021, pursuant to Section 19(b)(2) of the Act,⁷ 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.⁸ On November 1, 2021, the Exchange filed Amendment No. 1 to the proposed rule change.⁹ This order institutes proceedings pursuant to Section 19(b)(2)(B) of the Act¹⁰ to determine whether to approve or disapprove the proposed rule change.

II. Description of the Proposed Rule Change, as Modified by Amendment No. 1

⁵ See letter to Vanessa Countryman, Secretary, Commission, from Alanna Barton, General Counsel, BOX Exchange LLC, dated September 14, 2021 (“BOX Letter”); and letter from Mary Smith, dated August 19, 2021 (“Smith Letter”). Comments received regarding the proposal are available on the Commission’s website at: <https://www.sec.gov/comments/sr-cboe-2021-046/srcboe2021046.htm>.

⁶ See letter to Vanessa Countryman, Secretary, Commission, from Laura G. Dickman, Vice President and Associate General Counsel, Cboe Options, dated September 23, 2021 (“Exchange Response”). The Exchange Response is available on the Commission’s website at: <https://www.sec.gov/comments/sr-cboe-2021-046/srcboe2021046.htm>.

⁷ 15 U.S.C. 78s(b)(2).

⁸ See Securities Exchange Act Release No. 93159 (September 28, 2021), 86 FR 54780 (October 4, 2021). The Commission designated November 23, 2021, as the date by which the Commission shall approve or disapprove, or institute proceedings to determine whether to approve or disapprove, the proposed rule change.

⁹ Amendment No. 1 revises the proposal to provide rationale for allowing complex orders with any ratio equal to or greater than one-to-three and less than or equal to three-to-one to trade electronically; provide information regarding the number of additional contracts that would be permitted to trade in \$0.01 increments under the proposal; and express the view that the rules of another options exchange do not clearly specify the minimum trading increment applicable to complex orders traded on that exchange’s trading floor. Amendment No. 1 is available on the Commission’s website at <https://www.sec.gov/comments/sr-cboe-2021-046/srcboe2021046.htm>.

¹⁰ 15 U.S.C. 78s(b)(2)(B).

Currently, Exchange Rule 5.4 provides that, except as provided in Exchange Rule 5.33, the minimum increment for bids and offers on complex orders with any ratio equal to or greater than one-to-three and less than or equal to three-to-one for equity and index options, and Index Combo orders, is \$0.01 or greater, which the Exchange may determine on a class-by-class basis, and the legs may be executed in \$0.01 increments. The rule further provides that the minimum increment for bids and offers on complex orders with any ratio less than one-to-three or greater than three-to-one for equity and index options (except for Index Combo orders) is the standard increment for the class pursuant to Exchange Rule 5.4(a), and the legs may be executed in the minimum increment applicable to the class pursuant to Exchange Rule 5.4(a).¹¹ The Exchange proposes to amend Exchange Rule 5.4(a) to allow complex orders with any ratio to be quoted in increments of \$0.01 or greater, as determined by the Exchange on a class-by-class basis, and executed in \$0.01 increments.

The Exchange states that if complex orders cannot be expressed in increments smaller than the increment for the class (such as \$0.05), it may be difficult for brokers to obtain the desired prices for their customers' complex orders because the parties to a trade must perform complicated and time-consuming calculations to break down the orders into the required contract quantities and prices to fit within the constraint of executing the orders at a minimum increment other than \$0.01.¹² In addition, the Exchange notes that the calculation process for larger-ratio complex orders is time-consuming because these orders generally are entered in large quantities

¹¹ The minimum increment for bids and offers on complex orders in options on the S&P 500 Index (SPX) or on the S&P 100 Index (OEX and XEO), except for box/roll spreads, is \$0.05 or greater, or any increment, which the Exchange may determine on a class-by-class basis. See Cboe Rule 5.4(a).

¹² See Notice, 86 FR at 47530.

with a large number of legs.¹³ As a result, brokers executing larger-ratio complex orders on active trading days cannot be as efficient in representing other customer orders they are holding.¹⁴ The Exchange states that the proposal to allow larger-ratio complex orders to be quoted and executed in \$0.01 increments will provide market participants with flexibility in pricing their investment strategies and allow Trading Permit Holders (“TPHs”) to execute these orders more efficiently and at better prices for their customers.¹⁵

The Exchange notes that, in general, because fewer than one third of complex orders executed on the Exchange’s trading floor have ratios greater than three-to-one, a significant majority of the complex orders traded on the Exchange are eligible to execute in pennies.¹⁶ Accordingly, if the proposal increases the number of complex orders submitted with ratios greater than three-to-one (and thus the number of orders that may trade in pennies), the Exchange believes that any increase would represent a nominal increase in the volume that would be eligible to execute in pennies.¹⁷

Currently, the Exchange permits complex orders with any ratio less than one-to-three or greater than three-to-one to trade only on the Exchange’s trading floor.¹⁸ The Exchange proposes to allow these larger-ratio orders to be traded electronically, as well as in open outcry.¹⁹ The Exchange states that electronic trading of larger-ratio complex orders will provide investors

¹³ See Exchange Response at 4.

¹⁴ See Notice, 86 FR at 47530.

¹⁵ See id. at 47530-1.

¹⁶ See Amendment No. 1 at 4.

¹⁷ See id.

¹⁸ See Notice, 86 FR at 47529.

¹⁹ See id. at n. 6.

with additional flexibility in executing these orders and will increase the investment strategies available to investors who prefer to or solely trade electronically.²⁰

The Exchange asserts that it is unlikely that market participants would submit orders with any ratio equal to or greater than one-to-three and less than or equal to three-to-one that is not a bona fide trading strategy solely for the purpose of trading in \$0.01 increments.²¹ The Exchange states that it is unlikely that other market participants would be willing to execute against an order that is not a bona fide trading strategy, thereby reducing the likelihood that a market participant would be able to execute such a strategy.²² The Exchange further states that adding an extra leg to a large order to be able to improve the book by \$0.01 would be unnecessary because such order could be executed in an AIM Auction in \$0.01 increments.²³ In addition, the Exchange notes that these orders would be subject to review by the Exchange's regulatory division, which could determine that the submission of such orders was in violation of the Exchange's rules, including Exchange Rule 8.1, which prohibits TPHs from engaging in acts or practices inconsistent with just and equitable principles of trade.²⁴

The proposal does not extend the complex order priority provisions applicable to complex orders with any ratio equal to or greater than one-to-three and less than or equal to three-to-one to complex orders with any ratio less than one-to-three or greater than three-to-one.²⁵ The proposal amends Exchange Rule 5.33(f)(2)(A)(v) to provide that a complex order

²⁰ See Amendment No. 1 at 5.

²¹ See Notice, 86 FR at 47531.

²² See id.

²³ See id.

²⁴ See id.

²⁵ See Notice, 86 FR at 47530.

that has any ratio less than one-to-three or greater than three-to-one will not execute at a net price that would cause any component of the complex strategy to be executed at a price ahead of a Priority Customer order on the Simple Book²⁶ without improving the BBO²⁷ of each component of the complex strategy with a Priority Customer order at the BBO.²⁸ As a result, a complex order with any ratio less than one-to-three or greater than three-to-one may be executed at a net debit or credit price only if each leg of the order betters the corresponding bid (offer) of a Priority Customer order(s) in the Simple Book.²⁹ Accordingly, the Exchange states that the complex order priority rules will continue to protect Priority Customer interest on the Simple Book.³⁰

III. Summary of Comments and Exchange's Response

The Commission received two comment letters regarding the proposal.³¹ One commenter states that the proposal would solely benefit high-speed traders and result in worse prices for retail traders due to decreased quotes.³²

²⁶ The Simple Book is the electronic book of simple orders and quotes maintained by the System, which single book is used during both the Regular Trading Hours and Global Trading Hours trading sessions. See Exchange Rule 1.1.

²⁷ The BBO is the best bid or offer disseminated on the Exchange.

²⁸ See Exchange Rule 1.1. Exchange Rule 5.33(f)(2)(A)(v) will continue to provide that a complex order that has any ratio equal to or greater than one-to-three and less than or equal to three-to-one, or an Index Combo order, will not execute at a net price that would cause any component of the complex strategy to be executed at a price ahead of a Priority Customer Order on the Simple Book without improving the BBO of at least one component of the complex strategy.

²⁹ See Notice, 86 FR at 47530.

³⁰ See id.

³¹ See supra note 5.

³² See Smith Letter.

The Exchange states that the proposal is designed to increase the efficiency of trading larger-ratio, highly complex orders and is not intended to benefit high-speed traders.³³ The Exchange further states that the proposal has minimal relevance to high-speed traders, who generally participate in listed options trading as market makers rather than as brokers conducting agency businesses.³⁴ The Exchange concludes that the proposal “will have minimal impact on either high-speed traders or retail traders (or on the simple market), as it is intended to increase the efficiency and precision available to brokers attempting to execute highly complicated yet bona-fide multi-leg option strategies on the Exchange, which strategies are not common among high-speed traders or retail traders.”³⁵ In addition, the Exchange notes that the proposal is unrelated to quoting and that the increased number of complex orders that would be eligible for more flexible pricing under the proposal could increase the number of complex orders entered on the Exchange that may leg into the Simple Book, thereby increasing execution opportunities for resting customer orders.³⁶

Another commenter states that, contrary to statements in the proposal, each component leg of s of a multi-leg Qualified Open Outcry Order (“QOO”) on the BOX Exchange LLC’s (“BOX”) trading floor respects the minimum trading increment for the series (e.g., \$0.01, \$0.05, \$0.10).³⁷ The commenter further states that multi-leg QOO Orders do not meet the definition of

³³ See Exchange Response at 1-2.

³⁴ See id. at 2.

³⁵ Id. at 3-4.

³⁶ See id. at 2.

³⁷ See BOX Letter at 1.

Complex QOO Order and are treated like single-leg QOO Orders for purposes of execution and priority.³⁸

In its response, the Exchange states that multiple TPHs who are also members of BOX informed the Exchange that multi-legged orders with ratios greater than three-to-one or less than one-to-three are executed regularly on BOX's trading floor in penny increments.³⁹ The Exchange also expressed the view that BOX's rules lack clarity regarding the increments applicable to QOO Orders that do not satisfy the definition of a complex order in BOX Rule 7240(a)(7).⁴⁰

IV. Proceedings to Determine Whether to Approve or Disapprove SR-CBOE-2021-046 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act⁴¹ to determine whether the proposed rule change should be approved or disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as described below, the Commission seeks and encourages interested persons to provide comments on the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Act,⁴² the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to

³⁸ See id.

³⁹ See Exchange Response at 4.

⁴⁰ See id. at 4-5. See also Amendment No. 1 at 6-7.

⁴¹ 15 U.S.C. 78s(b)(2)(B).

⁴² Id.

allow for additional analysis of the proposed rule change’s consistency with Section 6(b)(5) of the Act,⁴³ 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,”⁴⁴ and not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.⁴⁵ The proposal would allow a complex order with any ratio less than one-to-three or greater than three-to-one to be quoted and executed in \$0.01 increments, regardless of the trading increment for the class. Thus, the component series of a complex order with any ratio less than one-to-three or greater than three-to-one in a class that trades in \$0.05 increments would be able to trade in \$0.01 increments, while single-leg orders in those series would trade in \$0.05 increments. The Commission believes that questions are raised as to whether this disparity in trading increments could disadvantage market participants trading single-leg orders in classes with a standard trading increment of \$0.05 or \$0.10.

V. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their data, views, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposal. In particular, the Commission invites the written views of interested persons concerning whether the proposed rule change is consistent with Section 6(b)(5) or any other provisions of the Act, or rules and regulations thereunder. Although

⁴³ 15 U.S.C. 78f(b)(5).

⁴⁴ Id.

⁴⁵ See id.

there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of data, views, and arguments, the Commission will consider, pursuant to Rule 19b-4 under the Act,⁴⁶ any request for an opportunity to make an oral presentation.⁴⁷

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule change should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register]. The Commission asks that commenters address the sufficiency and merit of the Exchange's statements in support of the proposal, in addition to any other issues raised by the proposed rule change raised under 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. Please include File No. SR-CBOE-2021-046 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.

⁴⁶ 17 CFR 240.19b-4.

⁴⁷ Section 19(b)(2) of the Act, as amended by the Securities Acts Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants to the Commission flexibility to determine what type of proceeding – either oral or notice and opportunity for written comments – is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Acts Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

All submissions should refer to File No. SR-CBOE-2021-046. The file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. SR-CBOE-2021-046 and

should be submitted by [insert date 21 days from the date of 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.⁴⁸

J. Matthew DeLesDernier
Assistant Secretary

⁴⁸ 17 CFR 200.30-3(a)(12); 17 CFR 200.30-3(a)(57).