

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-94204; File No. SR-CBOE-2021-046)

February 9, 2022

Self-Regulatory Organizations; Cboe Exchange, Inc.; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, 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 and to allow 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.³ The proposed rule change was published for comment in the Federal

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 Exchange 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 Exchange Rule 1.1.

Register on August 25, 2021.⁴ The 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 The Commission is publishing this notice to solicit comment on Amendment No. 1 and is approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

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

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 data indicating that in August 2021, fewer than one third of the complex orders executed on the Exchange’s trading floor had ratios of greater than three-to-one, so the significant majority of the approximately 25% of total executed non-SPX contracts (approximately 27% of total executed contracts) traded during that time would have been eligible to execute in \$0.01 increments; 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>.

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

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).¹⁰ 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 \$0.01.¹¹ 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 with a large number of

¹⁰ 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 Exchange Rule 5.4(a).

¹¹ See Notice, 86 FR at 47530.

legs.¹² 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.¹³ 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.¹⁴

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.¹⁵ To apply to electronic trading the priority provisions that currently apply to floor-traded complex orders with any ratio less than one-to-three or greater than three-to-one,¹⁶ the proposal amends Exchange Rule

¹² See Exchange Response at 4.

¹³ See Notice, 86 FR at 47530.

¹⁴ See id. at 47530-1.

¹⁵ See Notice, 86 FR at 47530. Exchange Rule 5.33(f)(2)(A)(v) currently provides that the Exchange’s system does not execute a complex order (i.e. 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)) pursuant to Exchange Rule 5.33 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 resting in the Simple Book without improving the BBO of at least one component of the complex strategy by at least one minimum increment. Exchange Rule 5.85(b)(1) states that a complex order (A) with any ratio equal to or greater than one-to-three (.333) and less than or equal to three-to-one (3.00) or (B) that is an Index Combo order may be executed at a net debit or credit price without giving priority to equivalent bids (offers) in the individual series legs that are represented in the trading crowd or in the Book if the price of at least one leg of the order improves the corresponding bid (offer) of a Priority Customer order(s) in the Book by at least one minimum trading increment as set forth in Rule 5.4(b). Exchange Rule 5.85(b)(2).

¹⁶ See Exchange Rule 5.85(b)(2) (stating that a complex order with any ratio less than one-to-three (.333) and greater than three-to-one (3.00) (except for an Index Combo order) may be executed in open outcry on the trading floor at a net debit or credit price without giving priority to equivalent bids (offers) in the individual series legs that are represented in the trading crowd or in the Book if each leg of the order betters the corresponding bid

5.33(f)(2)(A)(v) to provide that a complex order 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 Book¹⁷ without improving the BBO¹⁸ of each component of the complex strategy with a Priority Customer order at the BBO.¹⁹ As a result, the proposal will allow a complex order with any ratio less than one-to-three or greater than three-to-one to 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.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 First, the Exchange states that adding an extra leg to a large order to be able to improve the book by \$0.01 would be unnecessary because the order could be executed in an AIM Auction in \$0.01 increments.²² Second, the Exchange states that it is unlikely that other market participants would be

(offer) of a Priority Customer order(s) in the Book on each leg by at least one minimum trading increment as set forth in Rule 5.4(b)).

¹⁷ 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.

¹⁸ The BBO is the best bid or offer disseminated on the Exchange.

¹⁹ 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.

²⁰ See Notice, 86 FR at 47530.

²¹ See Notice, 86 FR at 47531.

²² See id.

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.²³ Third, 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

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.²⁵ The Exchange proposes to allow these orders to be traded electronically, as well as in open outcry.²⁶ The Exchange states that electronic trading of these larger-ratio complex orders will provide investors with additional flexibility in executing these orders and will increase the investment strategies available to investors who prefer to or solely trade electronically.²⁷

III. Summary of Comments and Exchange's Response

The Commission received two comment letters regarding the proposal.²⁸ One commenter stated that the proposal would solely benefit high-speed traders and result in worse prices for retail traders due to decreased quotes.²⁹

²³ See id.

²⁴ See id.

²⁵ See Notice, 86 FR at 47529.

²⁶ See id. at n. 6.

²⁷ See Amendment No. 1 at 5.

²⁸ See supra note 5.

²⁹ See Smith Letter.

The Exchange stated 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.³⁰ The Exchange further stated 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.³¹ The Exchange concluded 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.”³² In addition, the Exchange noted 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.³³

Another commenter stated that, contrary to statements made 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).³⁴ The commenter further stated that multi-leg QOO Orders do not meet the

³⁰ See Exchange Response at 1-2.

³¹ See id. at 2.

³² Id. at 3-4.

³³ See id. at 2.

³⁴ See BOX Letter at 1.

definition of Complex QOO Order and are treated like single-leg QOO Orders for purposes of execution and priority.³⁵

In its response, the Exchange stated 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.³⁶ 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).³⁷

IV. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.³⁸ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,³⁹ 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, and not be designed to permit unfair discrimination between customers, issuers, brokers or dealers. The proposal to

³⁵ See id.

³⁶ See Exchange Response at 4.

³⁷ See id. at 4-5. See also Amendment No. 1 at 6-7.

³⁸ 15 U.S.C. 78f(b). 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).

³⁹ 15 U.S.C. 78f(b)(5).

allow complex orders with a with any ratio less than one-to-three or greater than three-to-one to be quoted and executed in \$0.01 increments could provide market participants with flexibility in pricing these orders and allow TPHs to execute their customers' orders in these larger-ratio strategies at better prices. The proposal to allow complex orders with any ratio less than one-to-three or greater than three-to-one to trade electronically could provide market participants with flexibility in executing these orders by providing an additional means for trading them. The proposal will protect the priority of Priority Customer orders resting on the Simple Book by requiring each component of a complex order with a ratio less than one-to-three or greater than three-to-one to execute at a price that improves the BBO of each component of the order with a Priority Customer order at the BBO.⁴⁰

The Commission does not believe that the proposal will solely benefit high-speed traders and result in worse prices for retail traders due to decreased quotes. As noted above, the proposal will provide all market participants, including retail customers, with greater flexibility both in pricing complex orders with any ratio less than one-to-three or greater than three-to-one, and in executing these orders, which will be allowed to trade electronically as well as on the Exchange's floor. With respect to the second comment letter, the Commission notes that in approving this proposal it is not relying on statements made in the proposal or in any comment letters regarding BOX's trading floor.

⁴⁰ See proposed Exchange Rule 5.33(f)(2)(A)(v). This requirement is consistent with Exchange Rule 5.85(b)(2), which provides that a complex order with any ratio less than one-to-three (.333) and greater than three-to-one (3.00) (except for an Index Combo order) may be executed in open outcry on the trading floor at a net debit or credit price without giving priority to equivalent bids (offers) in the individual series legs that are represented in the trading crowd or in the Book if each leg of the order betters the corresponding bid (offer) of a Priority Customer order(s) in the Book on each leg by at least one minimum trading increment as set forth in Exchange Rule 5.4(b).

Finally, unlike the trading systems of some options exchanges, Cboe's trading system does not generate legging orders on behalf of complex orders. A legging order (sometimes called a derived order) is an exchange-generated single-leg limit order on the exchange's limit order book that represents either the bid or the offer of one component of a complex order resting on the exchange's complex order book. In general, a legging order is generated at a price: (i) that matches or improves upon the best displayed bid or offer on the exchange's single-leg limit order book; and (ii) at which the net price of the complex order can be achieved when the other leg is executed against the best displayed bid or offer on the exchange's single-leg limit order book.⁴¹ If an exchange generated legging orders in \$0.01 increments on behalf of complex orders with any ratio less than one-to-three or greater than three-to-one in a class with a standard trading increment of \$0.05, a complex order priced in a \$0.01 increment could generate a legging order at a price that would not be available to market participants trading single-leg orders.⁴² If an options market that generates legging orders in \$0.01 increments regardless of the trading increment for the class wished to allow complex orders with a ratio less than one-to-three or greater than three-to-one to trade in \$0.01 increments, the inability of single-leg orders to compete on a level playing field with the legging orders generated on behalf of these complex orders could raise regulatory concerns.

⁴¹ See e.g., BOX Rule 7240(c); ISE Rule Options 3, Section 7(k); and MIAX Rule 518(a)(9).

⁴² For example, if such an exchange received a complex order to buy series A and Series B at a net price of \$2.13, and there was an order on the exchange's single-leg book to sell series B for \$1.05, the exchange's system could generate a legging order to sell series A for \$1.08. If the quoting and trading increment for the class is \$0.05, then a market participant that entered a single-leg order to sell series A would be required to enter its order in a pricing increment of \$0.05 and would not be able to match, or better, the legging order's price by entering its order in a \$0.01 increment.

V. Solicitation of Comments on Amendment No. 1 to the Proposed Rule Change

Interested persons are invited to submit written data, views, and arguments concerning whether Amendment No. 1 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. Please include File Number 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.

All submissions should refer to File Number SR-CBOE-2021-046. 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-2021-046, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VI. Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 1

The Commission finds good cause to approve the proposed rule change, as modified by Amendment No. 1, prior to the thirtieth day after the date of publication of notice of the filing of Amendment No. 1 in the Federal Register. Amendment No. 1 provides 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. In addition, Amendment No. 1 provides data indicating that in August 2021, fewer than one third of the complex orders executed on the Exchange's trading floor had ratios of greater than three-to-one, so the significant majority of the approximately 25% of total executed non-SPX contracts (approximately 27% of total executed contracts) traded during that time would have been eligible to execute in \$0.01 increments. Amendment No. 1 raises no novel regulatory issues and provides additional analysis that assists the Commission in evaluating the Exchange's proposal and determining that it is consistent with the Act. Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act,⁴³ to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

⁴³ 15 U.S.C. 78s(b)(2).

VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁴⁴ that the proposed rule change (SR-CBOE-2021-046), as modified by Amendment No. 1, is approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴⁵

J. Matthew DeLesDernier
Assistant Secretary

⁴⁴ 15 U.S.C. 78s(b)(2).

⁴⁵ 17 CFR 200.30-3(a)(12).