

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-95987; File No. SR-CBOE-2022-041)

October 5, 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 Exchange Rule 5.34(b) Related to Price Protections and Risk Controls for Complex Orders

I. Introduction

On August 4, 2022, Cboe Exchange, Inc. (“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 (“Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend Exchange Rule 5.34(b) to revise the definition of butterfly spread and to adopt a new buy strategy price check that will reject or cancel vertical or butterfly spread orders to buy that have a price of zero and are not designated as either Immediate-or-Cancel (“IOC”) or Direct to PAR.<sup>3</sup> The proposed rule change was published for comment in the Federal Register on August 23, 2022.<sup>4</sup> On September 14, 2022, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>5</sup> The Commission has received no comment letters regarding the

---

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

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

<sup>3</sup> Under the Exchange’s rules, an Immediate-or-Cancel or IOC order is a limit order that must execute in whole or in part as soon as the System receives it; the System cancels and does not post to the Book an IOC order (or unexecuted portion) not executed immediately on the Exchange or another options exchange. Users may designate bulk messages as IOC. A User may not designate an IOC order as Direct to PAR. A Direct to PAR order is an order a User designates to be routed directly to a specified PAR workstation for manual handling. A User must designate a Direct to PAR order as RTH Only. See Exchange Rule 5.6(b).

<sup>4</sup> See Securities Exchange Act Release No. 95520 (August 17, 2022), 87 FR 51723 (“Notice”).

<sup>5</sup> Amendment No. 1 revises the proposal to (1) correct an error in the description section of the Form 19b-4 by stating that the component legs of a butterfly spread order have

proposal. 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.

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

As described more fully in the Notice, the Exchange proposes to amend Exchange Rule 5.34(b)(4) to adopt a new buy strategy price check for complex orders. Under proposed Exchange Rule 5.34(b)(4)(B), the System cancels or rejects a vertical or butterfly spread order to buy that has a price of zero and is not designated as either IOC or Direct to PAR, and the System does not initiate a Complex Order Auction (“COA”) with a vertical or butterfly spread order to

---

different strike prices; (2) provide additional explanation by stating that, in rare circumstances, market participants may seek to sell a vertical or butterfly spread at a price of zero to liquidate a position; (3) state that the proposal continues to provide execution opportunities for vertical and butterfly spread buy orders priced at zero through the IOC instruction or manual handling, while preventing these orders from overwhelming the Complex Order Book (“COB”); (4) state that the proposed price check does not extend to zero-priced vertical or butterfly spread sell orders, which will continue to be permitted to rest on the COB; (5) correct an error in the description section of the Form 19b-4 by stating that between January and July 2022, only 1.3% of the approximately 177 million zero-priced vertical and butterfly spread contracts (rather than orders) of the approximately 6.5 million orders submitted to rest in the COB, were filled; and (6) state that zero-bid vertical or butterfly spread orders may be submitted as part of a paired order as a cross on the trading floor or to a Complex Automated Improvement Mechanism (“C-AIM”) auction. Amendment No. 1 makes no changes to Exhibit 5 of the proposal. Amendment No. 1 is available on the Commission’s website at <https://www.sec.gov/comments/sr-cboe-2022-041/srcboe2022041.htm>.

buy that has a price of zero unless the order is auctioned via PAR.<sup>6</sup> The Exchange may apply the proposed price check on a class-by-class basis.<sup>7</sup>

The Exchange states that it has observed a significant and increasing number of zero-priced vertical and butterfly spread buy orders in certain classes submitted to rest in the COB.<sup>8</sup> The Exchange further states that these zero-priced buy orders execute infrequently against an opposing complex order and remain resting in the COB because market participants rarely desire to sell these strategies at a price of zero.<sup>9</sup> Based on its analysis of orders submitted from January 2022 through July 2022, the Exchange identified that approximately only 1.3% of the approximately 177 million zero-priced buy vertical and butterfly spread contracts, of the approximately 6.5 million orders submitted to rest in the COB, were filled.<sup>10</sup> The Exchange states that multiple Trading Permit Holders (“TPHs”) have expressed concern regarding the amount of excess market data that results from zero-priced vertical and butterfly spread buy strategies, and the Exchange believes that the high number of these orders may impede liquidity

---

<sup>6</sup> For purposes of Exchange Rule 5.34(b), a vertical spread is a two-legged complex order with one leg to buy a number of calls (puts) and one leg to sell the same number of calls (puts) with the same expiration date but different exercise prices, except as set forth in Exchange Rule 5.34(b)(3)(A). See Exchange Rule 5.34(b)(1)(A). As discussed below, Exchange Rule 5.34(b)(1)(B), as proposed to be amended, defines a butterfly spread as a three-legged complex order with two legs to buy (sell) the same number of calls (puts) and one leg to sell (buy) twice as many calls (puts), all with the same expiration date but different exercise prices, and the exercise price of the middle leg is between the exercise prices of the other legs. The System considers a true butterfly and a skewed butterfly to be a butterfly spread. If the exercise price of the middle leg is the average of the exercise prices of the other legs, it is a “true” butterfly; and if the exercise price of the middle leg is less in-the-money than the average of the exercise prices of the other legs, it is a “skewed” butterfly.

<sup>7</sup> See proposed Exchange Rule 5.34(b)(4)(B).

<sup>8</sup> See Notice, 87 FR at 51724.

<sup>9</sup> See id.

<sup>10</sup> See Amendment No. 1 at 4.

providers from executing against marketable customer interest because the stream of incoming strategies creates new data messages that liquidity providers must process and synthesize into their systems, interfering with their time and resources to process, synthesize, and react to data messages in connection with marketable customer interest.<sup>11</sup> In addition, the Exchange states that it has expended resources to implement multiple System enhancements to enable its System to continue to handle the large number of these strategies.<sup>12</sup>

The Exchange acknowledges that there may be limited cases in which market participants may seek to sell a zero-priced vertical or butterfly spread, including when liquidating a position.<sup>13</sup> Under the proposal, zero-priced vertical or butterfly spread sell orders will continue to be permitted to rest on the COB.<sup>14</sup> By requiring zero-priced vertical and butterfly spread buy orders to be designated as IOC or Direct to PAR, the Exchange states that proposed Exchange Rule 5.34(b)(4)(B) will ensure that these zero-priced buy orders are either executed immediately against marketable orders (in whole or in part) and then cancelled, or are sent to directly to a PAR workstation for manual handling by a Floor Broker.<sup>15</sup> The Exchange further states that by allowing zero-priced vertical and butterfly buy spread orders to be submitted only as IOC or for manual handling, including manual submission into a COA, the proposal continues to provide

---

<sup>11</sup> See Notice, 87 FR at 51724. In addition, the Exchange states that complex orders generate a COA auction message before resting in the COB and that the COA auction message volume resulting from the influx of zero-priced vertical and butterfly buy spread orders saturates the auction market data and may deter liquidity providers from providing auction liquidity, which adversely impacts customer orders. See id.

<sup>12</sup> See id.

<sup>13</sup> See Amendment No. 1 at 3.

<sup>14</sup> See id.

<sup>15</sup> See Notice, 87 FR at 51725. Proposed Exchange Rule 5.34(b)(4)(B) also allows a zero-priced vertical and butterfly spread buy order to initiate a COA if the order is auctioned via PAR.

execution opportunities for vertical and butterfly spread strategies that are legitimately priced at zero, while preventing a significant number of these orders from overwhelming the COB.<sup>16</sup> Proposed Exchange Rule 5.34(b)(4)(B) provides the Exchange with flexibility to apply the proposed price check on a class-by-class basis, which will permit the Exchange to determine whether allowing zero-priced vertical and butterfly spread orders to rest in the COB is appropriate for different option classes, which may exhibit different trading characteristics and have different market models.<sup>17</sup>

The proposal also revises the definition of butterfly spread in Exchange Rule 5.34(b)(1)(B) to more precisely define what the Exchange’s System considers to be true and skewed butterfly spreads for purposes of Exchange Rule 5.34(b) and to provide that the System considers both skewed and true butterfly spreads to be butterfly spreads. As described more fully in the Notice, Exchange Rule 5.34(b)(1)(B) currently states, in part, that “If the exercise price of the middle leg is halfway between the exercise prices of the other legs, it is a “true” butterfly; otherwise, it is a “skewed” butterfly.” The Exchange proposes to revise this sentence to state that “If the exercise price of the middle leg is the average of the exercise prices of the other legs, it is a “true” butterfly; and if the exercise price of the middle leg is less-in-the-money than the average of the exercise prices of the other legs, it is a “skewed” butterfly.” The Exchange states that the proposed changes more accurately reflect what the Exchange’s System considers to be a skewed butterfly and a butterfly spread generally.<sup>18</sup>

### III. Discussion and Commission Findings

---

<sup>16</sup> See id.

<sup>17</sup> See id.

<sup>18</sup> See Notice, 87 FR at 51725.

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.<sup>19</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>20</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 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.

For the reasons set forth below, the Commission believes that the proposal to adopt a price check that will reject or cancel vertical and butterfly spread buy orders with a price of zero that are not designated as IOC or Direct to PAR is designed to protect investors and the public interest. As discussed above, orders to buy a vertical or butterfly spread for a price of zero execute infrequently and instead remain resting in the COB without being filled.<sup>21</sup> The Exchange states that these zero-priced vertical and butterfly spread buy orders generate a substantial amount of market data that market participants must process and synthesize into their systems, and that this excess data, about which TPHs have expressed concern, may impede

---

<sup>19</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>20</sup> 15 U.S.C. 78f(b)(5).

<sup>21</sup> See Notice, 87 FR at 51724. As noted above, based on its analysis of such orders submitted from January 2022 through July 2022, the Exchange found that approximately only 1.3% of the approximately 177 million zero-priced buy vertical and butterfly spread contracts, of the approximately 6.5 million orders submitted to rest in the COB, were filled. See Amendment No. 1 at 4.

liquidity providers from executing against marketable customer interest.<sup>22</sup> Although vertical and butterfly spread buy orders priced at zero will no longer be permitted to rest in the COB, the proposal will provide for the continued execution of the limited number of vertical and butterfly spread orders that are legitimately priced at zero. In this regard, vertical and butterfly spread sell orders with a price of zero will continue to have the ability to rest in the COB and market participants will be able to submit zero-priced vertical and butterfly spread IOC buy orders to execute against the resting zero-priced sell orders.<sup>23</sup> In addition, the proposal will allow market participants to submit vertical and butterfly spread buy orders with a price of zero as Direct to PAR for manual handling, and market participants will continue to have the ability to submit zero-bid vertical and butterfly spread orders as part of a paired order in a crossing transaction.<sup>24</sup>

The Commission believes that the proposed changes to the definition of butterfly spread are designed to protect investors and the public interest by providing more precise definitions of skewed and true butterfly spreads.

#### IV. 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

---

<sup>22</sup> See Notice, 87 FR at 51724. In addition, the Exchange states that it has implemented multiple System enhancements to enable its System to handle the large number of these strategies. See *id.*

<sup>23</sup> See Amendment No. 1 at 3 and proposed Exchange Rule 5.34(b)(4)(B).

<sup>24</sup> See Exchange Rule 5.34(b)(4)(B) and Amendment No. 1 at 4.

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2022-041 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-2022-041. 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-2022-041, 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 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. As described more fully above, Amendment No. 1 revises the proposal to acknowledge more clearly that, in limited circumstances, vertical and butterfly spread sell orders may legitimately be priced at zero, including when a market participant seeks to liquidate a position. Amendment No. 1 also states that zero-priced vertical and butterfly spread sell orders will continue to have the ability to rest in the COB. Amendment No. 1 emphasizes that the proposal provides methods for executing vertical and butterfly spread buy orders priced at zero by allowing market participants to submit these orders as IOC or for manual handling, or as part of a paired crossing transaction. In addition, Amendment No. 1 replaces an incorrect reference to “approximately 177 million zero-priced buy vertical and butterfly spread orders” with a correct reference to “approximately 177 million zero-priced buy vertical and butterfly spread contracts,” which helps to ensure that the proposal accurately represents the scope of the issue that the proposal seeks to address. Amendment No. 1 raises no novel regulatory issues and provides additional discussion 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,<sup>25</sup> to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

---

<sup>25</sup> 15 U.S.C. 78s(b)(2).

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>26</sup> that the proposed rule change (SR-CBOE -2022-041), as modified by Amendment No. 1, is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>27</sup>

J. Matthew DeLesDernier

Deputy Secretary

---

<sup>26</sup> 15 U.S.C. 78s(b)(2).

<sup>27</sup> 17 CFR 200.30-3(a)(12).