

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-97950; File No. SR-CBOE-2023-018)

July 19, 2023

Self-Regulatory Organizations; Cboe Exchange, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Make Permanent the Operation of its Flexible Exchange Options Pilot Program Regarding Permissible Exercise Settlement Values for FLEX Index Options

I. Introduction

On April 10, 2023, Cboe Exchange, Inc. (“Exchange”) 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 make permanent the operation of its Flexible Exchange Options (“FLEX Options”) pilot program that permits P.M.-settled Flexible Exchange Index Options (“FLEX Index Options”) to expire on or within two business days of the third-Friday-of-the-month expirations for non-FLEX Options (“Pilot Program”).³ The proposed rule change was published for comment in the Federal Register on April 28, 2023.⁴ On June 8, 2023, pursuant to Section 19(b)(2) of the Exchange Act,⁵ 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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ A third-Friday-of-the month expiration is referred to as “Expiration Friday”. Prior to the Pilot Program, Exchange rules prohibited P.M.-settled FLEX Index Options to expire on any business day that falls on or within two business days of an Expiration Friday. During the Pilot Program, P.M.-settled FLEX Index Options are permitted on or within two business days of an Expiration Friday. See note 8, infra and accompanying text.

⁴ See Securities Exchange Act Release No. 97368 (April 24, 2023), 88 FR 26353 (“Notice”).

⁵ 15 U.S.C. 78s(b)(2).

the proposed rule change.⁶ The Commission has received no comment letters on the proposed rule change. The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act⁷ to determine whether to approve or disapprove the proposed rule change.

II. Description of the Proposed Rule Change

The Exchange proposes to make permanent the operation of its Flexible Exchange Options Pilot Program that permits the Exchange to list FLEX Index Options whose exercise settlement value is derived from closing prices of the component securities on the last trading day prior to expiration (“P.M. settlement”) that expire on or within two business days of a third Friday-of-the-month expiration day for a non-FLEX Option (other than quarterly index expiration options).⁸ As stated above, prior to the Pilot Program P.M.-settled FLEX Index Options were prohibited from expiring on or within two business days of an Expiration Friday.⁹

In January 2010, the Commission approved the Exchange rule that established the Pilot Program.¹⁰ At the time, the Commission stated its continued concern about the adverse effects and impact of P.M. settlements upon market volatility and the operation of fair and orderly

⁶ See Securities Exchange Act Release No. 97672, 88 FR 38930 (June 14, 2023). The Commission designated July 20, 2023, 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.

⁷ 15 U.S.C. 78s(b)(2)(B).

⁸ A “Quarterly Index Expiration” or “QIX” option is an index options contract that expires on the last business day of a calendar quarter. See CBOE Rule 4.11.

⁹ See note 3, *supra*.

¹⁰ Securities Exchange Act Release No. 61439 (January 28, 2010), 75 FR 5831 (February 4, 2010) (SR-CBOE-2009-087) (“FLEX P.M. Pilot Program Approval Order”). The initial pilot period was set to expire on March 28, 2011, which date was added to the rules in 2010. See Securities Exchange Act Release No. 61676 (March 9, 2010), 75 FR 13191 (March 18, 2010) (SR-CBOE-2010-026).

markets on the underlying cash market at or near the close of trading.¹¹ However, the Commission also recognized that allowing P.M. settlement for FLEX Index Options that expire on, or within two business days of, Expiration Friday may allow more market participants to benefit from trading customized-type options on the Exchange rather than the OTC market.¹² The Commission approved the Exchange's proposal on a pilot basis to allow the Exchange and the Commission to monitor and evaluate the Pilot Program for potential adverse market effects.¹³ In order to facilitate this assessment, the Exchange committed to provide the Commission with data and analysis in connection with the Pilot Program on an annual and interim basis.¹⁴ Although the pilot period was originally scheduled to end on March 28, 2011, the Exchange filed to extend the operation of the pilot on multiple occasions, which, pursuant to current CBOE Rule 4.21(b)(5)(B), is currently set to expire on the earlier of November 6, 2023 or the date on which the Pilot Program is approved on a permanent basis.¹⁵

¹¹ See FLEX P.M. Pilot Program Approval Order, 75 FR at 5832.

¹² Id.

¹³ Id.

¹⁴ Id.

¹⁵ See Securities Exchange Act Release Nos. 64110 (March 23, 2011), 76 FR 17463 (March 29, 2011) (SR-CBOE-2011-024); 66701 (March 30, 2012), 77 FR 20673 (April 5, 2012) (SR-CBOE-2012-027); 68145 (November 2, 2012), 77 FR 67044 (November 8, 2012) (SR-CBOE-2012-102); 70752 (October 24, 2013), 78 FR 65023 (October 30, 2013) (SR-CBOE-2013-099); 73460 (October 29, 2014), 79 FR 65464 (November 4, 2014) (SR-CBOE-2014-080); 77742 (April 29, 2016), 81 FR 26857 (May 4, 2016) (SR-CBOE-2016-032); 80443 (April 12, 2017), 82 FR 18331 (April 18, 2017) (SR-CBOE-2017-032); 83175 (May 4, 2018), 83 FR 21808 (May 10, 2018) (SR-CBOE-2018-037); 84537 (November 5, 2018), 83 FR 56113 (November 9, 2018) (SR-CBOE-2018-071); 85707 (April 23, 2019), 84 FR 18100 (April 29, 2019) (SR-CBOE-2019-021); 87515 (November 13, 2020), 84 FR 63945 (November 19, 2019) (SR-CBOE-2019-108); 88782 (April 30, 2020), 85 FR 27004 (May 6, 2020) (SR-CBOE-2020-039); 90279 (October 28, 2020), 85 FR 69667 (November 3, 2020) (SR-CBOE-2020-103); 91782 (May 5, 2021), 86 FR 25915 (May 11, 2021) (SR-CBOE-2021-031); 93500 (November 1, 2021), 86 FR 61340 (November 5, 2021) (SR-CBOE-2021-064); 94812 (April 28, 2022), 87 FR 26381 (May 4, 2022) (SR-CBOE-2022-020); 96239 (November 4, 2022), 87 FR 67985 (November 10, 2022) (SR-CBOE-2022-

Since the Pilot Program’s inception in 2010, the Exchange has submitted reports to the Commission regarding the Pilot Program that detail the Exchange’s experience with the Pilot Program, pursuant to the FLEX PM Pilot Program Approval Order.¹⁶ Specifically, the Exchange states it has submitted annual reports to the Commission analyzing volume and open interest for each broad-based FLEX Index Options class overlying a third Friday-of-the-month expiration day, P.M.-settled FLEX Index Options series.¹⁷ The Exchange further states that the annual reports also contain certain pilot period and pre-pilot period analyses of volume and open interest for third Friday-of-the-month expiration days, A.M.-settled FLEX Index series and third Friday-of-the-month expiration day Non-FLEX Index series overlying the same index as a third Friday-of-the-month expiration day, P.M.-settled FLEX Index Option.¹⁸ The Exchange states the annual reports also contain information and analysis of FLEX Index Options trading patterns, and index price volatility and underlying share trading activity for each broad-based index class overlying an Expiration Friday, P.M.-settled FLEX Index Option that exceeds certain minimum open interest parameters.¹⁹ The Exchange also provided, on a periodic basis, interim reports of volume and open interest.²⁰ The Exchange states, in its proposal, that, during the course of the Pilot Program, it has provided the Commission with any additional data or analyses the Commission requested if it deemed such data or analyses necessary to determine whether the

053); and 97452 (May 8, 2023), 88 FR 30822 (May 12, 2023) (SR-CBOE-2023-025) (extending the pilot program through the earlier of November 6, 2023 or the date on which the pilot program is approved on a permanent basis).

¹⁶ See Notice, 88 FR at 26354.

¹⁷ Id.

¹⁸ Id. at 26354-55.

¹⁹ Id. at 26355.

²⁰ Id.

Pilot Program was consistent with the Exchange Act.²¹ The Exchange states it has made public on its website all data and analyses previously submitted to the Commission under the Pilot Program,²² and will continue to make public any data and analyses it submits to the Commission while the Pilot Program is still in effect.²³

As set forth more fully in the Notice, the Exchange concludes that the Pilot Program does not negatively impact market quality or raise any unique or prohibitive regulatory concerns.²⁴ The Exchange states it has not identified any evidence from the pilot data indicating that the trading of P.M.-settled FLEX Options has any adverse impact on fair and orderly markets on Expiration Fridays for broad-based indexes or the underlying securities comprising those indexes, nor have there been any observations of abnormal market movements attributable to P.M.-settled FLEX Options from any market participants that have come to the attention of the Exchange.²⁵ In order to support its overall assessment of the Pilot Program, the Exchange includes both an assessment of a study conducted at the direction of the staff of the Commission's Division of Economic and Risk Analysis ("DERA") and the Exchange's review and analysis of pilot data.²⁶ Among other things, the Notice includes the Exchange's analysis of

²¹ Id.

²² Available at https://www.cboe.com/us/options/regulation/pm_settlement_pilot/flex/.

²³ See Notice, 88 FR at 26355.

²⁴ Id.

²⁵ Id.

²⁶ Id. at 26354-58. The Exchange states that while the DERA staff study and corresponding Exchange study specifically evaluated SPX options, the Exchange believes it is appropriate to extrapolate the data to apply to FLEX P.M. options. Id. at 26358.

end of day volatility as well as a comparison of the impact of quarterly index rebalancing versus P.M.-settled expirations.²⁷

The Exchange states that it completed an analysis intended to evaluate whether the introduction of P.M.-settled options impacted the quality of the A.M.-settled options market.²⁸ Specifically, the Exchange compared values of key market quality indicators (specifically, the bid-ask spread²⁹ and effective spread³⁰) in SPXW options both before and after the introduction of Tuesday expirations and Thursday expirations for SPXW options on April 18 and May 11, 2022, respectively.³¹ The Exchange states it believes analyzing whether the introduction of new SPXW P.M.-settled expirations (i.e., SPXW options with Tuesday and Thursday expirations) impacted the market quality of then-existing SPXW P.M.-settled expirations (i.e., SPXW options with Monday, Wednesday, and Friday expirations) provides a reasonable substitute to evaluate whether the introduction of P.M.-settled index options impacted the market quality of the underlying cash markets when the Pilot Program began.³² The Exchange also states that FLEX

²⁷ Id at 26356.

²⁸ Id at 26357.

²⁹ The Exchange calculated for each of SPXW options (with Monday, Wednesday, and Friday expirations) and SPY Weekly options (with Monday, Wednesday, and Friday expirations) the daily time-weighted bid-ask spread on the Exchange during its regular trading hours session, adjusted for the difference in size between SPXW options and SPY options (SPXW options are approximately ten times the value of SPY options).

³⁰ The Exchange calculated the volume-weighted average daily effective spread for simple trades for each of SPXW options (with Monday, Wednesday, and Friday expirations) and SPY Weekly options (with Monday, Wednesday, and Friday expirations) as twice the amount of the absolute value of the difference between an order execution price and the midpoint of the national best bid and offer at the time of execution, adjusted for the difference in size between SPXW options and SPY options.

³¹ See Notice, 88 FR at 26357. For purposes of comparison, the Exchange paired SPXW options and SPY options with the same moneyness and same days to expiration.

³² Id.

Options are nearly identical to non-FLEX Options and overly the same indexes.³³ Therefore, the Exchange believes analyzing the impact of new SPXW options on then-existing SPXW options permit the Exchange to extrapolate that it is unlikely the introduction of P.M.-settled FLEX Options significantly impacted the market quality of A.M.-settled options when the Pilot Program began.³⁴ The full analysis was submitted with the Exchange’s proposal in Exhibit 3.³⁵

Finally, the Exchange states that the significant changes in the closing procedures of the primary markets in recent decades, including considerable advances in trading systems and technology, has significantly minimized risks of any potential impact of P.M.-, cash-settled FLEX Options on the underlying cash markets.³⁶

III. Proceedings to Determine Whether to Approve or Disapprove SR-CBOE-2023-018 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act³⁷ 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 additional comment on the proposed rule change to inform the Commission’s analysis of whether to approve or disapprove the proposed rule change.

³³ Id. at 26358.

³⁴ Id.

³⁵ Id. at 26357.

³⁶ Id. at 26358.

³⁷ 15 U.S.C. 78s(b)(2)(B).

Pursuant to Section 19(b)(2)(B) of the Act,³⁸ the Commission is providing notice of the grounds for disapproval under consideration. As described above, the Exchange has proposed to make permanent the operation of its Pilot Program that permits FLEX Index Options to use P.M. settlement values on or within two business days of a third Friday-of the month expiration day for a non-FLEX Option. The Commission is instituting proceedings to allow for additional analysis of, and input from commenters with respect to, the proposed rule change’s consistency with the Act, and in particular, Section 6(b)(5) of the 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.³⁹

Specifically, it is not clear if the Exchange’s proposal contains sufficient analysis and data as it relates to FLEX Index Options and the Pilot Program. The Commission therefore believes that there are questions raised as to whether the analysis and data provided by the Exchange provides sufficient support to determine that the proposal is consistent with Section 6(b)(5) of the Act.⁴⁰

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 issued thereunder ... is on the self-regulatory organization [‘SRO’] that proposed the rule change.”⁴¹ The description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of

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Id.

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15 U.S.C. 78f(b)(5).

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Id.

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

its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding,⁴² and any failure of an SRO to provide this information may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Exchange Act and the applicable rules and regulations.⁴³

For these reasons, the Commission believes it is appropriate to institute proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act⁴⁴ to determine whether the proposal should be approved or disapproved.

IV. 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 Sections 6(b)(5) or any other provision of the 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 data, views, and arguments, the Commission will consider, pursuant to Rule 19b-4 under the Act,⁴⁵ any request for an opportunity to make an oral presentation.⁴⁶

⁴² Id.

⁴³ Id.

⁴⁴ 15 U.S.C. 78s(b)(2)(B).

⁴⁵ 17 CFR 240.19b-4.

⁴⁶ Section 19(b)(2) of the Act, as amended by the Securities Acts Amendments of 1975, Public Law 94-29 (Jun. 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.

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 AFTER DATE OF 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 AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*]. The Commission asks that commenters address the sufficiency of the Exchange's statements in support of the proposal, 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 (<https://www.sec.gov/rules/sro.shtml>); or
- Send an email to rule-comments@sec.gov. Please include File Number SR-CBOE-2023-018 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-2023-018. 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 (<https://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the

See Securities Acts Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

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 a.m. and 3 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. Do not include personal identifiable information in submissions; you should submit only information that you wish to make available publicly. We may redact in part or withhold entirely from publication submitted material that is obscene or subject to copyright protection. All submissions should refer to file number to File Number SR-CBOE-2023-018 and should be submitted by [INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴⁷

Sherry R. Haywood,

Assistant Secretary.

⁴⁷ 17 CFR 200.30-3(a)(57).