

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-102126; File No. SR-CBOE-2024-042)

January 6, 2025

Self-Regulatory Organizations; Cboe Exchange, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Permit Orders Comprised of Options and Futures Legs (“Future-Option Orders”)

I. Introduction

On September 17, 2024, 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” or “Exchange Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to permit future-option orders.³ The proposed rule change was published for comment in the Federal Register on October 8, 2024.⁴ The Commission has received no comments regarding the proposal.

On November 18, 2024, 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 the proposed rule change.⁶ This order institutes proceedings under Section 19(b)(2)(B) of the Act⁷ to determine whether to approve or disapprove the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The proposal states that a future-option order “which is deemed an inter-regulatory spread order for purposes of the Rules, is an order to buy or sell a stated number of units of an underlying or a related futures contract(s) coupled with the purchase or sale of an option contract(s) on the Exchange. The Exchange designates in which classes future-option orders are available.” See proposed Exchange Rule 1.1.

⁴ See Securities Exchange Act Release No. 101229 (Oct. 1, 2024), 89 FR 81592 (“Notice”).

⁵ 15 U.S.C. 78s(b)(2).

⁶ See Securities Exchange Act Release No. 101646 (Nov. 18, 2024), 89 FR 83723 (Nov. 22, 2024) (designating January 6, 2025, as the date by which the Commission shall either approve, disapprove, or institute proceedings to determine whether to disapprove the proposed rule change).

⁷ 15 U.S.C. 78s(b)(2)(B).

II. Description of the Proposed Rule Change

As described more fully in the Notice,⁸ the Exchange proposes to amend its rules to permit future-option orders, which would be comprised of both options and futures legs.⁹ The Exchange states that it is common for investors to engage in hedging or other investment strategies that involve options and related futures products, and that, to execute these strategies, investors must submit the options order to the Exchange and separately submit the futures order to a designated contract market (“DCM”) on which the futures trade.¹⁰ The Exchange states, for example, that market participants may obtain positions in Cboe Volatility Index (“VIX”) options through transactions on the Exchange and hedge those positions entering into a separate transaction on Cboe Futures Exchange, LLC’s (“CFE”) centralized market in VIX futures (“VX futures”).¹¹ The Exchange states that separate executions of this sort create additional risks, including the risk that one order will execute while the other does not and price risk resulting from the time it takes to complete both transactions.¹² The Exchange states that due to these risks and the complexities of multi-part transactions, market participants may instead transact in the over-the-counter (“OTC”) market or not obtain a hedge at all.¹³ The Exchange states that the proposal would adopt a mechanism to facilitate the execution of these cross-product transactions in a simple, efficient manner that reduces these execution and price risks.¹⁴

⁸ See supra note 4.

⁹ See Notice, 89 FR at 81593.

¹⁰ See id.

¹¹ See id.

¹² See id.

¹³ See id.

¹⁴ See id.

The proposal amends Exchange Rule 1.1 to define to define a “future-option order” as an order to buy or sell a stated number of units of an underlying or a related futures contract(s) coupled with the purchase or sale of an option contract(s) on the Exchange.¹⁵ The Exchange would designate in which classes future-option orders would be available.¹⁶ The Exchange states that it intends to initially permit future-option orders overlying VIX and that it may expand the availability of future-option orders to other underlying securities or indexes in the future.¹⁷ The Exchange further states that, if required, the Exchange would submit rule filings in connection with any such expansion; the Exchange states, for example, that it may determine that a different risk offset requirement (as discussed below) is appropriate for another underlying based on the characteristics of the overlying options and futures.¹⁸

The proposed definition of a future-option order includes a risk offset requirement and a User may submit a future-option order only if it satisfies the applicable risk offset requirement.¹⁹

¹⁵ The Exchange states that a “future-option order” is deemed an inter-regulatory spread order for purposes of the Exchange’s rules. The Exchange states that Exchange Rule 1.1 defines an inter-regulatory spread order as an order involving the simultaneous purchase and/or sale of at least one unit in contracts each of which is subject to different regulatory jurisdictions at stated limits, or at a stated differential, or at market prices on the floor of the Exchange. The Exchange states that the proposed rule change modernizes this definition to apply it to the Exchange in general, as opposed to the floor of the Exchange (the Exchange states that the definition of inter-regulatory spread order was adopted when all trading on the Exchange occurred in open outcry). See id. at footnote 3.

¹⁶ See Notice, 89 FR at 81593. The Exchange states that the proposed definition of a future-option order is similar to the definition of a stock-option order, and that Exchange Rule 1.1 defines a “stock-option order” as an order to buy or sell a stated number of units of an underlying or a related security coupled with either (a) the purchase or sale of option contract(s) on the opposite side of the market representing either the same number of units of the underlying or related security or the number of units of the underlying security necessary to create a delta neutral position or (b) the purchase or sale of an equal number of put and call option contracts, each having the same exercise price and expiration date, and each representing the same number of units of stock as, and on the opposite side of the market from, the underlying or related security portion of the order. The Exchange states that the primary difference is the stock-option order definition requires the order to be delta neutral, while the proposed definition of a future-option order requires the order to have a risk offset within a specified range (as described below). See id. at footnote 4.

¹⁷ See Notice, 89 FR at footnote 5.

¹⁸ See id.

¹⁹ See Notice, 89 FR at 81593.

The Exchange states that a risk offset requirement will provide market participants with sufficient flexibility to execute legitimate strategies comprised of options and futures while preventing a market participant from using the proposed execution mechanism to execute a futures trade outside of the normal trading process on the applicable DCM by combining the future leg(s), for example, with an inexpensive out-of-the-money option leg.²⁰ Pursuant to paragraph (a) of the proposed definition of future-option order, the System will accept a future-option order if the future leg(s) provides no less than 10% and no greater than 125% risk offset to the option leg(s).²¹ A future-option order satisfies this risk offset requirement if the net delta value of the order is no greater than -0.10 and no less than -1.25.²² The delta value of an option leg equals the expected change in the price of that options contract given a \$1.00 change in the price of the underlying security or index, and the delta value of a future leg equals the amount set forth in the rules or contract specifications of the DCM on which the future contract trades.²³ The delta value of each option and future leg is multiplied by the applicable multiplier.²⁴ The sum of the future legs delta values divided by the sum of the option legs delta values equals the net delta value for the order.²⁵

²⁰ See id.

²¹ See id. The Exchange states that the user must include a delta value for each option leg of the order when submitting a future-option order. See Exchange Rule 1.1 (proposed paragraph (b)(2) of definition of future-option order). The Exchange states that although a user may use any methodology it chooses to calculate the delta value of option legs, the value must be reasonable and will be subject to surveillance by the Exchange's regulatory division. The Exchange states that the System will use the user-submitted delta values to calculate the risk offset for the entire order. See id. at footnote 6.

²² See Notice, 89 FR at 81593 and paragraph (a)(1) of the proposed definition of future-option order.

²³ See paragraphs (a)(1)(A) and (B) of the proposed definition of future-option order.

²⁴ See paragraph (a)(1)(C) of the proposed definition of future-option order.

²⁵ See paragraph (a)(1)(D) of the proposed definition of future-option order.

For future-option orders overlying the Cboe Volatility Index (VIX), the System calculates the risk offset set forth in paragraph (a) using the net delta value for each “group” of option legs and future legs with the same expiration date.²⁶ The net delta value of each group must be no greater than -0.10 and no less than -1.25.²⁷ If any option contract leg or future contract leg cannot be grouped with any future leg(s) or option leg(s), respectively, the System rejects a VIX future-option order.²⁸

If the System determines that a complex strategy comprised of future and option legs satisfies the risk offset requirement, it accepts all future-option orders for that complex strategy for the remainder of that trading day.²⁹ The Exchange states that this will prevent a situation in which the Exchange accepts a future-option order for a specific complex strategy on a trading day but cannot execute against future-option orders for the same complex strategy submitted later that trading day but no longer satisfies the risk offset requirement because the delta values have changed since the initial order was submitted.³⁰

The Exchange states that the proposal also amends the definition of “complex order” in Exchange Rule 1.1 to provide that unless the context otherwise requires, the term complex order will include future-option orders.³¹

The Exchange states that, under proposed Exchange Rule 5.33(o), when a User submits a future-option order to the Exchange:

²⁶ See paragraph (a)(2) of the proposed definition of future-option order.

²⁷ See *id.*

²⁸ See *id.* An example of this calculation appears in the Notice at 89 FR at 81593.

²⁹ See paragraph (c) [sic] of the proposed definition of future-option order.

³⁰ See Notice, 89 FR at 81593-4. The Exchange states that it is for this reason a user may not designate a future-option order submitted for electronic processing as GTC or GTD, as provided in proposed Exchange Rule 1.1 (proposed paragraph (b)(1) of definition of future-option order). See *id.* at 81594, footnote 10.

³¹ See *id.* at 81594.

• if the User is also a member of the DCM on which the applicable future trades and the Exchange has established electronic communication with the DCM, the Exchange will electronically communicate the future component of the future-option order to the DCM on behalf of the User;³² or

• if the User is not also a member of the DCM on which the applicable future trades or opts out of the direct communication described above (or such direct communication is unavailable), the User must designate a specific futures commission merchant (“FCM”) or introducing broker (“IB”) with which it has entered into an agreement pursuant to proposed Exchange Rule 5.33, Interpretation and Policy .05 (the “designated FCM/ IB”) to which the Exchange will communicate the futures component of the future-option order on behalf of the User.³³ The Exchange states that proposed Interpretation and Policy .05 provides that if the User is not also a member of the DCM on which the applicable future trades or opts out of the direct communication (or such direct communication is unavailable), to submit a future-option order to the Exchange for execution, a User must enter into an agreement with one or more FCMs or IBs that are not affiliated with the Exchange, which FCM/IB(s) the Exchange has identified as having connectivity to electronically communicate the futures components of future-option

³² The Exchange states that, unlike stock, a future trades on one DCM, which would make such direct communication with the DCM possible. The Exchange states that this would only be available if the DCM and the Exchange established electronic communication between the two markets to permit this direct communication of the futures component. See id. at footnote 12.

³³ The Exchange states that only authorized Users and associated persons of Users may establish connectivity to and access the Exchange to submit orders. See Exchange Rule 5.5(a). The Exchange states that a “User” is defined as a Trading Permit Holder (“TPH”) or Sponsored User who is authorized to obtain access to the System pursuant to Exchange Rule 5.5. See Exchange Rule 1.1 (definition of User). The Exchange states that it currently has no Sponsored Users, so the term “User” at present is synonymous with the term “TPH.” The Exchange states that a User and any individuals associated with the User that submits a future-option order must have any required futures industry registrations and comply with applicable rules of the DCM on which the futures trades and the Commodity Futures Trading Commission (“CFTC”). See Notice, 89 FR at footnote 13.

orders to the DCM on which the futures trade.³⁴ The Exchange states that this will provide Users with flexibility to pick which FCM/IB will communicate the futures components of their orders for execution (if an FCM/IB is necessary for communication of the futures component to the DCM).³⁵

The Exchange states that the proposal adds future-option orders to the list of types of complex orders that may be accepted for electronic trading.³⁶ The Exchange states that future-option orders submitted for electronic processing may execute pursuant to a complex order auction (“COA”) if eligible, as described in Exchange Rule 5.33(d), or in the complex order book (“COB”) as described in Exchange Rule 5.33(e) and will execute in the same manner as other complex orders, except as described herein.³⁷ The Exchange states that future-option orders may also be submitted for execution (if eligible) in the complex automated improvement mechanism (“C-AIM”), as described in Exchange Rule 5.38, or the complex solicitation auction mechanism (“C-SAM”) as described in Exchange Rule 5.40.³⁸ The Exchange further states that the proposal amends Exchange Rule 5.70(b) to provide that the Exchange may make future-option orders available for flexible (FLEX) options trading.³⁹

The Exchange states that it proposes to adopt Exchange Rule 5.33(f)(1)(C) to provide that Users may express bids and offers for a future-option order in any decimal price the Exchange

³⁴ The Exchange states that this requirement is substantially identical to that required for stock-option orders. See Notice, 89 FR at footnote 14.

³⁵ The Exchange states that it intends to establish an arrangement with one or more FCMs/IBs that are members of the applicable DCM, pursuant to which arrangement those FCMs/IBs will have connectivity to the Exchange to receive the futures components of future-option orders and communicate those to the applicable DCM for execution of these futures components. See Notice, 89 FR at footnote 15.

³⁶ See Notice, 89 FR at 81594.

³⁷ See id.

³⁸ See id. at 81595.

³⁹ See id. at footnote 16.

determines, which will allow the Exchange to accommodate the available pricing of futures.⁴⁰

The minimum increment for the option leg(s) of a future-option order is \$0.01 or greater, which the Exchange may determine on a class-by-class basis, regardless of the minimum increments otherwise applicable to the option leg(s), and the future leg(s) of a future-option order may be executed in any decimal price permitted in the DCM on which the applicable futures trade.⁴¹

The Exchange states that smaller minimum increments are appropriate for future-option orders as the future component may be able to trade at finer decimal increments permitted by the DCM on which the futures trade.⁴² The Exchange states that even with the flexibility provided in the proposed rule, the individual options legs must trade at increments allowed by the Commission.⁴³

As described more fully in the Notice, the Exchange states that the proposed electronic execution process of future-option orders is substantially similar to that of stock-option orders.⁴⁴

If a future-option order can execute upon entry or following a COA, or if it can execute following evaluation while resting in the COB pursuant to Exchange Rule 5.33(i), the System will execute the option component (which may consist of one or more option legs) of a future-option order against the option component of other future-option orders resting in the COB or COA responses pursuant to the allocation algorithm applicable to the class, but will not immediately send the User a trade execution report, and then will automatically communicate the future component(s) to the DCM or the designated FCM/IB, as applicable, for execution at the DCM on which the futures trade.⁴⁵ If the System receives an execution report for the future

⁴⁰ See Notice, 89 FR at 81594.

⁴¹ See proposed Exchange Rule 5.33(f)(1)(C).

⁴² See Notice, 89 FR at 81594.

⁴³ See id.

⁴⁴ See id.

⁴⁵ See proposed Exchange Rule 5.33(o)(2)(A).

component from the DCM or the designated FCM/IB, as applicable, the Exchange will send the User the trade execution report for the future-option order, including execution information for the future and option components.⁴⁶ If the System receives a report from the DCM or the designated FCM/IB, as applicable, that the future component(s) cannot execute, the Exchange will nullify the option component trade and notify the User of the reason for the nullification.⁴⁷ The Exchange states that such nullification without a request from the User is consistent with the purpose of future-option orders, as contingent execution at or near the same time (and thus reduction in price and execution risk) is one of the primary goals of future-option orders.⁴⁸ A future-option order that is not marketable will rest in the COB (if eligible to rest) or route to PAR for manual handling, subject to a User's instructions.⁴⁹

Proposed Exchange Rule 5.33(f)(2)(C) states that for a future-option order with one option leg, the option leg may not trade at a price worse than the individual component price on the simple book or at the same price as a priority customer order on the simple book. The Exchange states that, for a future-option order with more than one option leg, the option legs must trade at price pursuant to Exchange Rule 5.33(f)(2)(A), which is the permissible execution prices and priority for complex orders comprised of option legs.⁵⁰ Therefore, the Exchange states that the System will not execute a future-option order at a net price: (1) that would cause any

⁴⁶ See proposed Exchange Rule 5.33(o)(2)(B).

⁴⁷ See proposed Exchange Rule 5.33(o)(2)(B). The Exchange states that the execution of the futures component must satisfy requirements of the applicable DCM, including informational and reporting time requirements, risk controls, and price restrictions (such as needing to be within the daily quotation range). The Exchange states that, pursuant to Exchange Rule 5.33(k), trading in any complex strategy (including one that comprises a future-option order) is suspended if any component of a complex strategy (including a future leg) is halted. Therefore, if trading in a future is halted, it could not execute and would result in the future-option order not being executed. See Notice, 89 FR at footnote 21.

⁴⁸ See Notice, 89 FR at 81595.

⁴⁹ See proposed Exchange Rule 5.33(o)(2).

⁵⁰ See Notice, 89 FR at 81595 and proposed Exchange Rule 5.33(f)(2)(C)(ii).

option component of the complex strategy to be executed at a price of zero; (2) that would cause any option component of the complex strategy to be executed at a price worse than the individual component prices on the simple book; (3) worse than the price that would be available if the complex order legged into the simple book; or (4) worse than the synthetic best bid or offer (“SBBO”)⁵¹ or equal to the SBBO when there is a priority customer order on any leg comprising the SBBO and, if a conforming complex order,⁵² at least one option component of the complex order must execute at a price that improves the best bid or offer (“BBO”) for that component by at least one minimum increment or, if a nonconforming complex order,⁵³ the option component(s) of the complex order for the leg(s) with a priority customer order at the BBO must execute at a price that improves the price of that priority customer order(s) on the simple book by at least one minimum increment.⁵⁴ The Exchange states that, pursuant to the proposed changes, the option component(s) of a future-option order will ultimately trade in the

⁵¹ See Notice, 89 FR at 81595. The Exchange states that the proposal revises the definition of SBBO in Exchange Rule 5.33(a) to provide that the SBBO is the best net bid and best net offer on the Exchange for a complex strategy calculated using, for future-option orders, the BBO for each component (or the national best bid or offer (“NBBO”) for a component if the BBO for that component is not available) and the daily quotation range for each future component. The Exchange states that the proposal revises the definition of synthetic national best bid or offer (“SNBBO”) in Exchange Rule 5.33(a) to provide that the SNBBO is the national best net bid and net offer for a complex strategy calculated using, for future-option orders, the NBBO for each option component and the daily quotation range for each future component. See Notice, 89 FR at footnote 22.

⁵² The Exchange states that the proposal amends the definition of “conforming complex order” in Exchange Rule 1.1 to provide that a future-option order is conforming (1) if the ratio on the options legs is greater than or equal to one-to-three (.333) or less than or equal to three-to-one (3.00) or (2) the options legs comprise an Index Combo order (as defined in Exchange Rule 5.33(b)). See Notice, 89 FR at footnote 23.

⁵³ The Exchange states that the proposal amends the definition of “nonconforming complex order” in Exchange Rule 1.1 to provide that a future-option order is nonconforming if the ratio of its options legs is less than one-to-three (.333) or greater than three-to-one (3.00) (unless the options legs comprise an Index Combo order). See Notice, 89 FR at footnote 24.

⁵⁴ The Exchange states that all-or-none complex orders (including future-option orders) may only execute at prices better than the SBBO. See Notice, 89 FR at footnote 25.

same manner and in accordance with the same priority principles as they would if they had been submitted without a future leg.⁵⁵

The Exchange states that the proposal also amends rules in Chapter 5, Section G of the Exchange's rulebook to describe the execution of future-option orders in open outcry on the Exchange's trading floor, which the Exchange states is substantially similar to the open outcry process for stock-option orders.⁵⁶ The Exchange states that the proposal amends Exchange Rule 5.83(b) to provide that the Exchange may make future-option orders available for PAR routing for manual handling, and further amends this provision to provide that the Exchange may determine to make nonconforming future-option orders not eligible for electronic processing, in which case such orders would only be eligible for manual handling and open outcry trading.⁵⁷ The Exchange states that the proposal amends Exchange Rule 5.85(g) to provide that a bid or offer that is identified to the trading crowd as part of a future-option order is made and accepted subject to the following conditions (which are the same conditions applicable to stock-option orders): (1) at the time the future-option order is announced, the Trading Permit Holder ("TPH") initiating the order must disclose to the crowd all legs of the order and identify the specific market(s) on which and the price(s) at which the non-option leg(s) of the order is to be filled; and (2) concurrent with the execution of the options leg of the order, the initiating TPH and each TPH that agrees to be a contra-party on the non-option leg(s) of the order must take steps immediately to transmit the non-option leg(s) to the identified market(s) for execution.⁵⁸ The

⁵⁵ See Notice, 89 FR at 81595.

⁵⁶ See id.

⁵⁷ See id.

⁵⁸ See id. The Exchange states that the proposal also updates Exchange Rule 5.85(g)(2) to provide that a trade representing execution of the options leg of a future-option order may be cancelled at the request of any TPH that is a party to that trade only if market conditions in any of the non-Exchange market(s) prevent the execution of the non-option leg(s) at the price(s) agreed upon. See id. at footnote 26.

Exchange states that proposed Exchange Rule 5.85(b)(3) provides that (like the stock component of stock-option orders) a floor broker or PAR official may, subject to a User's instructions, route the future component of a future-option order represented in open outcry to the DCM or an Exchange-designated FCM/IB not affiliated with the Exchange for execution at a DCM on which the futures trade in accordance with proposed Exchange Rule 5.33, Interpretation and Policy .05.⁵⁹ The Exchange also proposes to add subparagraph (5) to Exchange Rule 5.85(g) (which the Exchange states is substantially similar to Exchange Rule 5.85(g)(4) for stock-option orders) to provide that a TPH or PAR official may route the future component of an eligible future-option order represented in open outcry from PAR directly to a designated FCM/IB (as defined in Exchange Rule 5.33(o)) not affiliated with the Exchange for electronic execution at the DCM on which the futures trade (1) in accordance with the order's terms, and (2) as a single order or as a paired matching order (including with orders transmitted from separate PAR workstations).⁶⁰ The Exchange states that TPHs seeking to route the future component of a future-option order represented in open outcry through PAR to an Exchange-designated FCM/IB not affiliated with the Exchange for electronic execution at the DCM on which the futures trade must comply with proposed Exchange Rule 5.33(o).⁶¹ The Exchange proposes to amend Exchange Rule 5.91(g) to provide that, as they currently can for complex orders (including stock-option orders), floor brokers may leg future-option orders where one of the legs is executed on the Exchange.⁶²

⁵⁹ See Notice, 89 FR at 81595-6.

⁶⁰ See id. at 81596.

⁶¹ See id.

⁶² See id.

The Exchange states that the proposal amends Exchange Rule 5.85(b)(3) to describe the priority that will apply to future-option orders executed on the Exchange's trading floor.⁶³ The Exchange states that, under the proposal, future-option orders, like stock-option orders, will have priority over bids (offers) of in-crowd market participants on the trading floor but not over priority customer bids (offers) in the book.⁶⁴ Further, the Exchange states that the options legs of conforming and nonconforming future-option orders may be executed at the same net debit and credit prices as the options legs of stock-option orders.⁶⁵ Pursuant to proposed Exchange Rule 5.85(b)(4), a conforming future-option 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 option 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 Exchange Rule 5.4(b).⁶⁶ The Exchange states that, pursuant to proposed Exchange Rule 5.85(b)(5), a nonconforming future-option 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 each option leg of the order betters

⁶³ See id.

⁶⁴ See id.

⁶⁵ See id.

⁶⁶ The Exchange states that if there is a priority customer order on every leg comprising the SBBO, at least one option leg of the future-option order must execute at a price that improves the price of the priority customer order on the simple book for that leg by at least one minimum increment. The Exchange states that this is the same priority that applies to a conforming complex order (comprised of all option legs) as set forth in Exchange Rule 5.85(b)(1), and thus the options legs of a conforming future-option order will execute subject to the same priority as they would if they had been submitted without a future leg. See Notice, 89 at footnote 29.

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).⁶⁷

The Exchange states that the proposal amends Exchange Rule 6.5, Interpretation and Policy .07 to describe how a future-option order may qualify as an obvious error, that future-option orders will be handled in a similar manner to stock-option orders for purposes of Exchange Rule 6.5.⁶⁸ The Exchange states that if the option leg of a future-option order qualifies as an obvious error under Exchange Rule 6.5(c)(1) or catastrophic error under Exchange Rule 6.5(d)(1), then the option leg that is an obvious or catastrophic error will be adjusted in accordance with Exchange Rule 6.5(c)(4)(A) or (d)(3), respectively, regardless of whether one of the parties is a customer.⁶⁹ The Exchange states that the option leg of any customer future-option order will be nullified if the adjustment would result in an execution price higher (lower) for buy (sell) transactions than the customer's limit price on the future-option order, and the Exchange will attempt to nullify the future leg.⁷⁰ The Exchange states that when a DCM nullifies the futures leg(s) of a future-option order or when the future leg(s) cannot be executed, the Exchange will nullify the option leg upon request of one of the parties to the transaction or in accordance with Exchange Rule 6.5(c)(3).⁷¹ The Exchange states that the proposal adds Interpretation and Policy .02 to Exchange Rule 6.6 to clarify that TPHs may update only the

⁶⁷ See Notice, 89 FR at 81596. The Exchange states that if there is a priority customer order on any leg(s) comprising the SBBO, the component(s) of the future-option order for the option leg(s) with a priority customer order at the BBO must execute at a price that improves the price of that priority customer order(s) on the simple book by at least one minimum increment. The Exchange states that this is the same priority that applies to a nonconforming complex order (comprised of all option legs) as set forth in Exchange Rule 5.85(b)(2), and thus the options legs of a nonconforming future-option order will execute subject to the same priority as they would if they had been submitted without a future leg. See id. at footnote 30.

⁶⁸ See Notice, 89 FR at 81596.

⁶⁹ See id.

⁷⁰ See id.

⁷¹ See id.

option component of a future-option order trade using Clearing Editor (and as permitted by Exchange Rule 6.6), and that any updates to the future component would need to be done in accordance with the Rules of the applicable DCM (if permissible).⁷²

The Exchange states that execution of the options components of future-option orders will be subject to Commission jurisdiction, and execution of the futures components of future-option orders will be subject to Commodity Futures Trading Commission (“CFTC”) jurisdiction.⁷³ The Exchange further states that each of the Exchange and the DCM on which the futures component of a future-option order trades will regulate conduct relating to future-option orders and trades with respect to compliance with its rules, including bringing disciplinary actions for violations of its rules.⁷⁴ The Exchange states that before authorizing a class of future-option orders to trade on the Exchange, the Exchange would enter into an information sharing agreement with the DCM on which the applicable future trades that encompasses information relating to future-option orders and trades, which would allow for the sharing of information between the Exchange and the DCM to permit the Exchange (and the DCM) to have access to all order, trade, regulatory, and other data relating to these orders and trades.⁷⁵

The Exchange states that the proposal will provide investors with greater opportunities to manage risk and will provide investors with a more efficient mechanism to execute options and related future products, which investors regularly trade as part of hedging and other investment strategies.⁷⁶ The Exchange states that the proposed execution mechanism for future-option

⁷² See id.

⁷³ See id.

⁷⁴ See id.

⁷⁵ See id.

⁷⁶ See id. at 81597.

orders will make the trading and hedging process for investment strategies comprised of option and future components more efficient, which will reduce execution, legging, and price drift risk that otherwise accompanies the current execution process for these strategies.⁷⁷ The Exchange states that today, investors seeking to execute an investment strategy comprised of option and future components must do so through separate trades—one for the options and one for the futures, which creates risk that one trade occurs but the other does not, and which may leave an investor with an unhedged position.⁷⁸ In addition, the Exchange states that separate transactions create risk because market conditions may change between the time it takes to execute both transactions, which may make the full package execute in an unfavorable manner for the investor.⁷⁹ The Exchange states that although investors may continue to execute these strategies as separate transactions, the proposed execution process (both electronic and open outcry) will provide investors with an optional, alternative means to execute strategies comprised of future and options components that will reduce these risks, as it will permit the entire package to be priced together and will result in an execution only if both the options and futures components are able to trade.⁸⁰ The Exchange states that the proposed single execution mechanism therefore expands the ability of market participants to engage in cross-product investment and hedging transactions, which the Exchange believes will contribute to reduced overall market risk and increased liquidity.⁸¹

⁷⁷ See id.

⁷⁸ See id.

⁷⁹ See id.

⁸⁰ See id.

⁸¹ See id.

The Exchange believes the proposed rule change is designed to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade.⁸² The Exchange states that the proposed risk offset requirement is designed to provide market participants with sufficient flexibility to execute legitimate options strategies comprised of options and futures while preventing misuse of this mechanism, such as a market participant using the proposed execution mechanism to execute a futures trade outside of the normal trading process on the applicable DCM by combining the future leg(s), for example, with an inexpensive out-of-the-money option leg.⁸³

The Exchange states that the Commission and the CFTC will maintain jurisdiction over execution of the options and futures components, respectively, of future-option orders.⁸⁴ The Exchange states that each of the Exchange and the DCM on which the futures component of a future-option order trades will regulate conduct relating to future-option orders and trades with respect to compliance with its rules, including bringing disciplinary actions for violations of its rules.⁸⁵ The Exchange states that it is a member of the Intermarket Surveillance Group (“ISG”). The Exchange states that ISG members work together to coordinate surveillance and investigative information sharing in the futures and options markets, and that the Exchange would therefore have access to information regarding relevant trading activity from other ISG members, including applicable DCMs (as CFE is) that are also members.⁸⁶ The Exchange states that before authorizing a class of future-option orders to trade on the Exchange, if the applicable

⁸² See id.

⁸³ See id.

⁸⁴ See id.

⁸⁵ See id.

⁸⁶ See id.

DCM was not a member of ISG, or if the applicable DCM was a member of ISG but the Exchange still deemed appropriate, the Exchange would enter into an information sharing agreement with the DCM on which the applicable future trades that encompasses information relating to future-option orders and trades.⁸⁷ The Exchange states that this would allow for the sharing of information between the Exchange and the DCM to permit the Exchange (and the DCM) to have access to all order, trade, regulatory, and other data relating to these orders and trades, and thus facilitate the intermarket surveillance of future-option orders.⁸⁸ The Exchange states that, as a self-regulatory organization, it recognizes the importance of surveillance, among other things, to detect and deter fraudulent and manipulative trading activity as well as other violations of Exchange rules and the federal securities laws.⁸⁹ The Exchange states that its current rules prohibiting market manipulation and fraudulent, noncompetitive, and disruptive trading practices will apply to future-option orders, and that the Cboe Regulatory Division will incorporate information it receives from the DCM into its surveillance procedures to monitor trading of future-option orders, including to detect any manipulative trading activity.⁹⁰ The Exchange states that its surveillance, along with the proposed risk offset requirement, are reasonably designed to detect manipulative trading and enforce compliance with the proposed rules and other Exchange Rules.⁹¹ The Exchange states that it performs ongoing evaluations of its surveillance program to ensure its continued effectiveness and will continue to review its

⁸⁷ See id.

⁸⁸ See id.

⁸⁹ See id.

⁹⁰ See id.

⁹¹ See id.

surveillance procedures on an ongoing basis and make any necessary enhancements and/ or modifications that may be needed for future-option orders.⁹²

The Exchange states that the proposal will provide investors with the ability to execute their investment strategies in a listed market environment as opposed to in the unregulated OTC market and may shift liquidity from the OTC market onto the Exchange (as well as shift swaps and OTC combos from the OTC market onto designated contract markets in the form of futures), which the Exchange believes would increase market transparency as well as enhance the process of price discovery conducted on the Exchange through increased order flow, to the benefit of all investors.⁹³ The Exchange states that it may be a more attractive alternative to the OTC market, because of, among other things: (1) enhanced efficiency in initiating and closing out positions; (2) increased market transparency; and (3) heightened contra-party creditworthiness due to clearing requirements for listed options and futures.⁹⁴ The Exchange states that the Commission previously approved an Exchange proposal that permitted the trading of inter-regulatory spreads comprised of S&P 500 Index options and CBOE 50 futures, and S&P 100 Index options and S&P 250 futures.⁹⁵

III. Proceedings to Determine Whether to Approve or Disapprove SR-CBOE-2024-042 and Grounds for Disapproval under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act⁹⁶ 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

⁹² See id.

⁹³ See id. at 81598.

⁹⁴ See id.

⁹⁵ See Notice, 89 FR at footnote 38.

⁹⁶ 15 U.S.C. 78s(b)(2)(B).

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,⁹⁷ 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 Section 6(b)(5) of the Act,⁹⁸ 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 protect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

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 that proposed the rule change.”⁹⁹ 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,¹⁰⁰ and any failure of a self-regulatory organization 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 Act and the applicable rules

⁹⁷ See id.

⁹⁸ 15 U.S.C. 78f(b)(5).

⁹⁹ 17 CFR 201.700(b)(3).

¹⁰⁰ See id.

and regulations.¹⁰¹ As discussed above, the Exchange states that it initially proposes to make future-option orders available for VIX, and that it may expand the availability of future-option orders to other underlying securities or indexes in the future.¹⁰² However, the proposed rules do not specifically limit the availability of future-option orders to VIX, nor do they identify the permissible underliers for future-option orders.¹⁰³ In addition, although all future-option orders would be subject to a risk offset requirement, the proposed rules establish a methodology for calculating the risk offset only for VIX.¹⁰⁴ The Exchange states that it may determine that a different risk offset requirement is appropriate for another underlying based on the characteristics of the overlying options and futures.¹⁰⁵ Instituting proceedings will allow for additional consideration and clarification of the intended scope of the proposal, including whether the proposal should be limited to future-option orders on underliers for which the Exchange has established a methodology for calculating the risk offset requirement.

The Exchange states that the proposed risk offset requirement will provide market participants with sufficient flexibility to execute legitimate strategies comprised of options and

¹⁰¹ See id.

¹⁰² See Notice, 89 FR at footnote 5.

¹⁰³ The proposed definition of future-option order in Exchange Rule 1.1 states: “A future-option order, which is deemed an inter-regulatory spread order for purposes of the Rules, is an order to buy or sell a stated number of units of an underlying or a related futures contract(s) coupled with the purchase or sale of an option contract(s) on the Exchange. The Exchange designates in which classes future-option orders are available.”

¹⁰⁴ Paragraph (a)(1) of the proposed definition of future-option order states: “The System accepts a future-option order if the future leg(s) provides no less than 10% and no greater than 125% risk offset to the option leg(s). A future-option order satisfies this risk offset requirement if the net delta value of the order is no greater than -0.10 and no less than -1.25.” Paragraph (a)(2) of the proposed definition of future-option order states: “For future-option orders overlying the Cboe Volatility Index (VIX), the System calculates the risk offset set forth in paragraph (a) [sic] above using the net delta value for each “group” of option legs and future legs with the same expiration date. The net delta value of each group must be no greater than -0.10 and no less than -1.25. If any option contract leg or future contract leg cannot be grouped with any future leg(s) or option leg(s), respectively, the System rejects a VIX future-option order.”

¹⁰⁵ See Notice, 89 FR at footnote 5.

futures while preventing a market participant from using the proposed execution mechanism to execute a futures trade outside of the normal trading process on the applicable DCM by combining the future leg(s), for example, with an inexpensive out-of-the-money option leg.¹⁰⁶ The proposal provides no discussion or analysis describing how the Exchange developed the proposed risk offset requirement, including the permitted range of the risk offset, or why the Exchange believes that the proposed risk offset requirement—as opposed to another risk offset requirement or other metric—would be an effective means for permitting the execution of legitimate trading strategies while preventing misuse of the mechanism. Instituting proceedings will allow for additional analysis and consideration of issues related to the proposed risk offset requirement, including whether the Exchange has adequately described the operation of the proposed risk offset requirement, how the Exchange developed and selected the proposed risk offset requirement, how the proposed risk offset requirement will accomplish its stated purpose, and how the Exchange will determine when a different risk offset requirement would be appropriate.

The proposal requires a User to include a reasonable delta value for each option leg and the risk offset percentage of the order.¹⁰⁷ The Exchange states that “While a user may use any methodology it chooses to calculate the delta value of option legs, the value must be reasonable and will be subject to surveillance by the Exchange’s regulatory division.”¹⁰⁸ The proposal provides no discussion of how the Exchange will determine that User-assigned delta values are reasonable or how the Exchange will surveil for compliance with this requirement. Instituting proceedings will allow further discussion and consideration of how the Exchange will monitor

¹⁰⁶ See Notice, 89 FR at 81593.

¹⁰⁷ See paragraph (b)(2) of the proposed definition of future-option order.

¹⁰⁸ See Notice, 89 FR at footnote 6.

compliance with the requirement that Users assign a reasonable delta value to each option leg of the order.

In addition, as noted above, the Exchange states that execution of the options components of future-option orders will be subject to Commission jurisdiction, and execution of the futures components of future-option orders will be subject to CFTC jurisdiction.¹⁰⁹ Instituting proceedings will allow for additional analysis and consideration of issues related to any jurisdictional issues.

The Commission is instituting proceedings to allow for additional consideration and comment on the issues discussed above. In particular, the Commission asks commenters to address whether the proposal includes sufficient analysis with respect to the issues discussed above to support a conclusion that the proposal is consistent with the requirements of Section 6(b)(5) of the Act.

IV. 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 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 Act, and 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

¹⁰⁹ See Notice, 89 FR at 81596.

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.¹¹⁰

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*].

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-2024-042 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-2024-042. This file number should be included on the subject line if email 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

¹¹⁰ Section 19(b)(2) of the Act, as amended by the Securities Acts 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 Acts Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

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 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 SR-CBOE-2024-042 and should be submitted on or before [INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*]. Rebuttal comments should be submitted by [INSERT DATE 35 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹¹¹

Sherry R. Haywood,
Assistant Secretary.

¹¹¹ 17 CFR 200.30-3(a)(57).