

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-82689; File No. SR-CBOE-2018-016)

February 12, 2018

Self-Regulatory Organizations; Cboe Exchange, Inc.; Notice of Filing of a Proposed Rule Change to Amend Rules Related to the Complex Order Book

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that, on February 2, 2018, Cboe Exchange, Inc. (the “Exchange” or “Cboe Options”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend its rules related to the Complex Order Book (“COB”).

(additions are underlined; deletions are [bracketed])

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**Cboe Exchange, Inc.
Rules**

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Rule 6.53C. Complex Orders on the Hybrid System

(a) – (b) No change.

(c) **Complex Order Book:**

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

(i) Routing of Complex Orders: The Exchange will determine which classes and which complex order origin types (i.e., non-broker-dealer public customer, broker-dealers that are not Market-Makers or specialists on an options exchange, and/or Market-Makers or specialists on an options exchange) are eligible for entry into the COB and whether such complex orders can route directly to the COB and/or from PAR to the COB. In a class in which the Exchange determines complex orders of Market-Makers and specialists on an options exchange are not eligible for entry into the COB, the Exchange may determine that Market-Makers and specialists may enter complex orders into the COB if:

(A) their complex orders are on the opposite side of (1) a priority customer complex order(s) resting in the COB with a price not outside the national spread market; or (2) order(s) on the same side of the market in the same strategy that initiated a COA(s) if there are “x” number of COAs within “y” milliseconds, counted on a rolling basis (the Exchange determines the number “x” (which must be at least 2) and time period “y” (which may be no more than 2,000)); and

(B) they cancel their complex orders, if they remain unexecuted, no later than a specified time (which the Exchange determines and may be no more than five minutes) after the time the COB receives the Market-Maker order.

Complex orders not eligible to route to COB (either directly or from PAR to COB) will route via the order handling system pursuant to Rule 6.12.

(ii) – (iv) No change.

(d) No change.

... Interpretations and Policies:

.01 – .12 No change.

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The text of the proposed rule change is also available on the Exchange’s website (<http://www.cboe.com/AboutCBOE/CBOELegalRegulatoryHome.aspx>), at the Exchange’s Office of the Secretary, and at the Commission’s Public Reference Room.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in

Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend its rules related to the COB. Currently, Rule 6.53C(c)(i) states the Exchange may determine which classes and which complex order origin types (*i.e.*, non-broker-dealer public customer, broker-dealers that are not market-makers or specialists on an options exchange, and/or Market-Makers or specialists on an options exchange) are eligible for entry into the COB and whether such complex orders can route directly to the COB and/or from PAR to the COB.³ To the extent an origin type is not eligible for entry into the COB, complex orders with that origin type may still be entered into the System as opening-only or immediate-or-cancel, as such orders would not rest in the COB when the Exchange is open for trading.

The Exchange proposes to amend Rule 6.53C(c) to provide in a class in which the Exchange determines complex orders of Market-Makers and away market-makers are not eligible for entry into the COB, the Exchange may determine that Market-Makers and away market-makers may enter complex orders into the COB if (1) their complex orders are on the

³ Currently, Cboe Options has determined Market-Maker (origin code "M") and market-maker or specialist on an options exchange ("away market-makers") (origin code "N") complex orders in options on the S&P 500 ("SPX" and "SPXW") and the Cboe Volatility Index ("VIX") are not eligible for entry into the COB. See Regulatory Circular RG15-195. The group of SPX options with standard third-Friday settlements trade under the SPX symbol on the Hybrid 3.0 trading system, and the group of SPX options with other settlements trade under the SPXW symbol on the Hybrid trading system. Pursuant to Rule 8.14, Interpretation and Policy .01(c), the Exchange may establish different trading parameters for each group to the extent the Exchange Rules otherwise provide for such parameters to be established on a class basis.

opposite side of (A) a priority customer complex order(s) resting in the COB with a price not outside the national spread market (“NSM”)⁴ or (B) order(s) on the same side of the market in the same strategy that initiated a COA(s) if there are “x” number of COAs within “y” milliseconds, counted on a rolling basis (the Exchange will determine⁵ the number “x” (which must be at least 2) and time period “y” (which may be no more than 2,000)) and (2) they cancel their complex orders, if such orders remain unexecuted, no later than a specified time (which the Exchange determines and may be no more than five minutes) after the time the COB receives the order. The Exchange intends to set these parameters at levels it believes will permit Market-Makers to have sufficient time to submit orders into the COB to participate in COAs, which determination the Exchange will make based on Market-Maker feedback, business conditions, and data (including trading volume data and information regarding number of executions of Market-Maker orders against complex orders).

Unlike the leg markets, in which market-makers provide liquidity through quotes, the COB has no market-maker quotes that indicate to customers the price at which liquidity providers are willing to trade against their orders.⁶ Allowing market-makers to enter orders on the COB when there are priority customer orders on the opposite side will provide those customers with this information, thus creating potential execution opportunities for customers whose orders are not satisfied by the leg markets or other complex orders. The Exchange believes the proposed rule change will add liquidity for resting priority customer complex orders

⁴ See Rule 1.1(dddd) [sic].

⁵ Pursuant to Rule 6.53C, Interpretation and Policy .01, the Exchange will announce to Trading Permit Holders all determinations it makes pursuant to Rule 6.53C via Regulatory Circular. The Exchange will provide Trading Permit Holders with sufficient, advanced notice prior to changing any parameters its sets under the proposed rule change.

⁶ Market-makers are unable (and not required to) submit quotes in the COB.

in classes in which the Exchange has determined M and N complex orders are not eligible for entry into the COB, thus increasing execution opportunities at prices potentially better than the leg markets.

Additionally, the Exchange believes it may be difficult for Market-Makers to respond to auctions, particularly when multiple auctions occur within a short amount of time, while managing risk related to the amount executed during those auctions. Market-makers have complicated risk modeling associated with their trading activity, which factors in the size, price, and frequency at which they trade with orders. In the leg markets, those risk models factor in market-makers' quotes. However, the Exchange understands Market-Makers have separate systems for quoting and for monitoring and responding to COAs, each of which has a different risk model and set of risk controls. For example, one server process submits quotes while another server process scans the market for opportunities, such as the presence of customer orders and auctions.

It is common for Market-Makers to set risk controls with respect to the COA monitoring and response system to not respond to too many COAs within a short timeframe. If multiple COAs in a strategy occur within a short amount of time, it is common for a Market-Maker's system to determine this to be a potential system issue of the submitting Trading Permit Holder or Exchange. To ensure a Market-Maker does not trade with potentially erroneous orders and protect the Market-Maker from erroneous transactions to ensure it does not become overexposed to risk, the Market-Maker's system that monitors COAs may stop responding to COAs in this situation pursuant to the Market-Maker's risk controls for that system (e.g., the system may be programmed to only respond to a specific number of auctions within a time period). This ultimately reduces auction liquidity and potential price improvement for COA orders.

Additionally, this may result in the Market-Maker missing opportunities to participate in legitimate auctions. However, it is common for market participants to enter multiple small orders into COAs that are not erroneous (e.g., in accordance with market participants' algorithmic trading that may break up larger orders when hedging large portfolios). To the extent a Market-Maker's system stops responding to COAs in the above situation, a person may review the COAs and determine in its discretion it is appropriate to trade with the COA orders even if the System does not permit it due to automatic controls. Under the proposed rule change, that person could then submit an order to the COB that would be available to trade against those multiple COA orders up to the amount the Market-Maker is willing to trade. Even if the COAs were the result of an error by the submitting market participants, the Market-Maker that submitted a complex order that ultimately executes against those erroneous COA orders still had an opportunity to review the sizes and prices of those orders and evaluate how much and at what prices it is willing to trade. This is no different than the possibility of a market-maker quote resting in the leg market executing against an erroneously entered order.⁷ It is easier, and faster, for a person to submit an order to the COB to cover the amount of contracts it is willing to trade than enter individual responses to COAs given the brief COA response period (currently 100 milliseconds). Allowing Market-Makers to enter orders on the COB when there are multiple auctions occurring in short periods of time permits Market-Makers to post their trading interest up to the total amount of contracts within a single strategy they desire to trade within their risk controls for orders (as an order on the COB may trade against various COA orders), which limits execution risk while permitting them to continue to provide liquidity to price improvement

⁷ The Exchange may nullify a transaction or adjust the execution price of a transaction in accordance with Rule 6.25.

auctions.⁸

The Exchange believes the proposed rule change also permits it to maintain the protections in those classes gained from not having M and N complex orders otherwise resting in the COB by only permitting M and N complex orders to rest in the COB under certain circumstances for limited time periods. In classes in which there is significant open outcry trading, there is generally a large number of complex orders that execute in open outcry, and such orders are generally for significant quantity. There is a risk of orders in the COB interfering with this trading. For example, if a broker represents a large buy complex order on the floor, if there is a small sell order in the COB for that strategy at a better price, the broker must trade with that resting order first. While this affords price improvement for a small portion of the buy order, this first execution lengthens the time of execution for the entire order, which may ultimately harm the customer with respect to the overall price given the speed at which the market changes. Additionally, if there is a small buy order for that strategy in the COB at a better bid price, the floor broker would not be able to clear that order and would not be able to trade until that order is no longer resting on the book at a better price. This would ultimately disadvantage the floor broker's customer, who must now wait for execution. While non-market-maker orders are permitted in the COB in these classes, the Exchange believes these risks would be significantly heightened if market-maker orders were permitted to rest on the COB, as the Exchange expects market-makers would rest many smaller orders in reaction to hearing an order represented by a broker, which could block open outcry transactions more frequently.

For the following examples, suppose the NBBO for the VIX October 14 call is 2.50 to

⁸ Pursuant to Rule 6.53C(d), a Market-Maker or away market-maker order on the opposite side of the auctioned order resting on the COB may be available for execution against any contracts of the auctioned order that did not execute during the auction.

2.60, and the market for the VIX October 14 put is 1.50 to 1.60. Therefore, the NSM for a straddle⁹ is 4.00 to 4.20. Pursuant to the proposed rule change, the Exchange permits M and N orders to rest in VIX when there is an opposing side customer order resting in the COB with a price not outside \$4.00 and \$4.20 or if there are at least two COAs within a 1,000 millisecond interval, and provides Market-Makers with three minutes to cancel orders once those Market-Maker orders are received into the COB.

Example #1

- At 10:00 a.m., a customer submits to the COB an order to buy 20 of the VIX October 14 straddle at \$4.10 (there are no other customer orders resting in the COB to buy this strategy at any price).
- At 10:01 a.m., the customer order is still resting, and the COB receives a Market-Maker order to sell 50 of the VIX October 14 straddle at \$4.12. The Market-Maker must cancel the order by 10:04 a.m.
- At 10:04 a.m., the Market-Maker cancels the order.
- At 10:04:30 a.m., the same customer order continues to rest on the COB, and the Market-Maker enters another order to sell the straddle at \$4.11. The Market-Maker must cancel that order by 10:07:30 a.m.
- At 10:07 a.m., the Market-Maker cancels the order.

Example #2

- At 10:31 a.m., a customer submits to the COB an order to buy 20 of the VIX October 14 straddle at \$3.99 (there are no other customer orders resting in the COB to buy this strategy at any price).

⁹ A straddle order buys or sells the put and call of the same series.

- Market-Makers would not be permitted to enter opposing orders into the COB, because the customer order resting in the COB is priced outside of the NSM.
- At 10:35 a.m., the NSM changes from \$4.00 to \$4.20 to \$3.90 to \$4.10, and thus the resting customer order is now within the NSM.
- At 10:38 a.m., the COB receives a Market-Maker order to sell 50 of the straddle at \$4.00.
- At 10:40 a.m., the customer cancels its resting order and submits a new order to buy 20 of the straddle at \$4.00, which executes against the resting Market-Maker order.¹⁰ At 10:41 a.m., the Market-Maker cancels the remaining 30 of the straddle.

Example #3

- At 10:00:00:000 a.m., a customer submits an order to buy the VIX October 14 straddle, which initiates a COA (there was no other COA within the previous 1000 milliseconds), so Market-Makers may not submit an order into the COB.
- At 10:00:00:999 a.m., another customer submits an order to buy the VIX October 14 straddle, which initiates another COA. As this is the second COA within a one thousand millisecond interval, Market-Makers may submit orders to the COB.
- At 10:01:000 a.m., a Market-Maker submits to the COB an order to sell the VIX October 14 straddle at \$4.12.
- The Market-Maker must cancel the order by 10:04:000 a.m.

The time period within which a Market-Maker must cancel its complex order pursuant to

¹⁰ Note the customer receives a better price than is currently offered in the leg markets – to get an execution in the leg markets, the customer would have had to buy the straddle at \$4.10.

the proposed rule change provides the Market-Maker with sufficient time for the opposing customer to potentially re-price its order for execution against the Market-Maker's order or for the Market-Maker order to execute against an order following a COA, while also giving the Market-Maker sufficient time to manually cancel its unexecuted orders while managing all of its trading activity. A time period that is too short may discourage market-makers from entering orders under these circumstances, but a time period that is too long may eliminate the benefits of not permitting market-maker orders to rest in the COB (as discussed above). Additionally, requiring customer orders to be not outside the NSM for Market-Makers to submit orders to the COB prevents situations in which market participants may take advantage of this functionality. For example, a customer may rest an order in the COB that is far outside the NSM (and thus unlikely to execute) for long periods of time, which would then permit Market-Makers to rest orders in the COB for such long periods of time, because if a Market-Maker order on the COB does not trade, the Market-Maker could cancel it pursuant to the proposed rule change and then re-submit the order to the COB.

The Exchange's Regulatory Division will have surveillance in place to enforce the proposed rule change, which surveillance will monitor whether M and N orders have only been entered in the permitted circumstances described above, and whether any such unexecuted orders have been cancelled by the deadline imposed by the proposed rule change.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Securities Exchange Act of 1934 (the "Act") and the rules and regulations thereunder applicable to the Exchange and, in particular, the requirements of Section 6(b) of the Act.¹¹ Specifically, the

¹¹ 15 U.S.C. 78f(b).

Exchange believes the proposed rule change is consistent with the Section 6(b)(5)¹² requirements that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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. Additionally, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)¹³ requirement that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

In particular, the Exchange believes the proposed rule change will add liquidity and increase customer execution opportunities at prices potentially better than the leg markets for resting priority customer complex orders and auctioned orders in classes in which the Exchange has determined M and N orders are otherwise not eligible for entry into the COB, while maintaining the protections in those classes gained from not having M and N complex orders otherwise resting in the COB,¹⁴ which benefits investors. Unlike the leg markets, in which market-makers provide liquidity through quotes, the COB has no market-maker quotes that indicate to customers the price at which liquidity providers are willing to trade against their orders. Allowing market-makers to enter orders on the COB when there are priority customer orders on the opposite side will provide those customers with this information, thus creating

¹² 15 U.S.C. 78f(b)(5).

¹³ Id.

¹⁴ As discussed above, in classes in which there is significant open outcry trading, the Exchange is aware of risk that market-makers could rest orders in the COB at prices that would interfere with executions by in-crowd market participants.

potential execution opportunities for customers whose orders are not satisfied by the leg markets or other complex orders.

Additionally, the Exchange believes it may be difficult for Market-Makers to respond to auctions, particularly when multiple auctions occur within a short amount of time, while managing risk related to amount executed during those auctions. Market-makers have complicated risk modeling associated with their trading activity, which factors in the size, price, and frequency at which they trade with orders. In the leg markets, those risk models factor in market-makers' quotes. However, the Exchange understands Market-Makers have separate systems for quoting and for monitoring and responding to COAs, each of which has a different risk model and set of risk controls. It is common for Market-Makers to set risk controls with respect to the COA monitoring and response system to not respond to too many COAs within a short timeframe. If multiple COAs in a strategy occur within a short amount of time, it is common for a Market-Maker's system to determine this to be a potential system issue of the submitting Trading Permit Holder or Exchange. To ensure a Market-Maker does not trade with potentially erroneous orders and protect the Market-Maker from erroneous transactions, the Market-Maker's system that monitors COAs may stop responding to COAs in this situation pursuant to the Market-Maker's risk controls for that system. This ultimately reduces auction liquidity and potential price improvement for COA orders. Allowing Market-Makers to enter orders on the COB when there are multiple auctions occurring in short periods of time permits Market-Makers to post their trading interest up to the total amount of contracts within a single strategy they desire to trade within their risk controls for orders (as an order on the COB may trade against various COA orders), which limits execution risk while permitting them to continue to provide liquidity to price improvement auctions.

Therefore, the proposed rule change will improve Market-Makers' ability to trade against orders auctioned in a short period of time while managing their risk and thus increase execution opportunities for these orders. M and N complex orders provide customers with additional information regarding prices at which there is interest in the strategies. Current rules permit the Exchange to allow M and N orders into the COB; the rule change merely provides the Exchange with flexibility to allow this if certain conditions exist. The time period within which a Market-Maker must cancel its complex order pursuant to the proposed rule change provides the Market-Maker with sufficient time for the opposing customer to potentially re-price its order for execution against the Market-Maker's order or for the Market-Maker order to execute against an order following a COA, while also giving the Market-Maker sufficient time to manually cancel its unexecuted orders while managing all of its trading activity. A time period that is too short may discourage market-makers from entering orders under these circumstances, as they may not have time to cancel the order in time while managing all their trading activity, but a time period that is too long may eliminate the benefits of not permitting market-maker orders to rest in the COB (as discussed above). Additionally, requiring customer orders to be not outside the NSM for Market-Makers to submit orders to the COB prevents situations in which market participants may take advantage of this functionality – for example, a customer may rest an order in the COB that is far outside the NSM (and thus unlikely to execute) for long periods of time, which would then permit Market-Makers to rest orders in the COB for such long periods of time, because if a Market-Maker order on the COB does not trade, the Market-Maker could cancel it pursuant to the proposed rule change and then re-submit the order to the COB.

The Exchange's Regulatory Division will have surveillance in place to enforce the proposed rule change, which surveillance will monitor whether M and N orders have only been

entered in the permitted circumstances described above, and whether any such unexecuted orders have been cancelled by the deadline imposed by the proposed rule change.

B. Self-Regulatory Organization's Statement on Burden on Competition

Cboe Options does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. Current Rule 6.53C(c) permits the Exchange to determine M and N complex orders are not eligible to rest in the COB; the rule change merely provides the Exchange with flexibility to allow this if certain conditions exist. The proposed rule change permits Market-Makers to submit complex orders for entry into the COB, and cancel such orders if they remain unexecuted, in the same circumstances in those classes. If permitted, Market-Makers may enter complex orders for entry into the COB in their discretion; such order entry will not be required. Market-Makers may continue to enter opening only or immediate-or-cancel complex orders in those classes, or submit no complex orders in those classes, as they do today. Market-Makers have differing levels of resources, and some may determine to not expend resources to update systems to automatically recognize that conditions exist to permit them to rest orders in the COB. However, through discussions with Market-Makers, the Exchange understands any such system updates to require minimal expenditure. Additionally, it is possible for Market-Makers to manually observe the existence of conditions that would permit them to rest orders in the COB, and manually cancel them within the required timeframe. The proposed rule change does not require Market-Makers to submit orders to the COB if the conditions in the proposed rule change exist; such order submission would be voluntary and in Market-Makers' discretion. The proposed rule change provides all Market-Makers with the ability to submit orders to the COB in these circumstances.

The Exchange believes the proposed rule change will add liquidity and increase customer execution opportunities at prices potentially better than the leg markets for resting priority customer complex orders and auctioned orders in classes in which the Exchange has determined M and N orders are not otherwise eligible for entry into the COB. The proposed rule change will apply in the same manner to all Market-Makers in the classes in which the Exchange permits the proposed activity. The proposed rule change has no impact on intermarket competition, as it relates solely to orders that the Exchange permits to rest in its COB.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The Exchange neither solicited nor received comments on the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

- A. by order approve or disapprove such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change 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-2018-016 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-2018-016. 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, D.C. 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such 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-2018-016, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁵

Eduardo A. Aleman
Assistant Secretary

¹⁵ 17 CFR 200.30-3(a)(12).