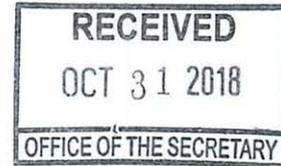


**MURPHY &
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October 30, 2018

VIA HAND DELIVERY

Brent Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

SEC
Mail Processing
Section
OCT 30 2018
Washington DC
415

**RE: Petition for Review of Order Approving Proposed Rule Change to Amend
Exchange Rule 6.49A, Transfer of Positions; Exchange Act Release No.
84437, File No. SR-CBOE-2018-060**

Dear Mr. Fields:

As counsel for Susquehanna International Group, LLP (collectively, and with its affiliated and related entities, "SIG"), please find enclosed the original and three copies of SIG's Petition for Review of Order Approving Proposed Rule Change to Amend Exchange Rule 6.49A, Transfer of Positions (Securities Exchange Act Release No. 34-84437, File No. SR-CBOE-2018-060).

Any questions concerning this matter can be directed to me at (202) 661-7028.

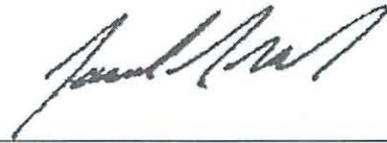
Very Truly Yours,

Joseph C. Lombard

CERTIFICATE OF SERVICE

I, Joseph C. Lombard, counsel for Susquehanna International Group, LLP, hereby certify that on October 30, 2018, I served the foregoing Petition for Review of Order Approving Proposed Rule Change to Amend Exchange Rule 6.49A, Transfer of Positions (Securities Exchange Act Release No. 34-84437, File No SR-CBOE-2018-060) on Brent J. Fields, Secretary, Securities and Exchange Commission, by causing hand delivery of the original and three copies to 100 F Street, N.E., Washington, D.C. 20549-1090.

Dated: October 30, 2018



Joseph C. Lombard

RECEIVED
OCT 31 2018
OFFICE OF THE SECRETARY

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

_____)
In the Matter of the Petition of:) File No. SR-CBOE-2018-060
)
)
)
Susquehanna International)
Group, LLP)
)
)
_____)

PETITION FOR REVIEW OF ORDER
ENTERED PURSUANT TO DELEGATED AUTHORITY
APPROVING AMENDMENTS TO RULE 6.49A BY CBOE EXCHANGE, INC.

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Pursuant to Rule 430 of the Rules of Practice of the Securities and Exchange Commission (“SEC” or the “Commission”), Susquehanna International Group, LLP (collectively with its affiliated and related entities, “SIG”) hereby petitions the Commission for review of the October 16, 2018 Order set forth in Exchange Act Release No. 84437 (the “Order”) in which the Staff of the Division of Trading and Markets (the “Staff”), pursuant to delegated authority, approved a proposed rule change by Cboe Exchange, Inc. (“CBOE” or the “Exchange”) severely limiting off-exchange transfers that do not result in any change of beneficial ownership of the transferred options positions.

Preliminary Statement

If recently approved amendments to CBOE Rule 6.49A are not disapproved by the Commission, one of two things will happen that will undermine the U.S. securities markets with respect to listed options: either internal risk management transfers that embody no change in beneficial ownership will be reported to the consolidated options tape and disseminated to the public as if they were arms-length transactions, or those positions will be neither transacted nor transferred at all, which will cause the market risk of the respective firm to needlessly increase, and the public perception of actual options open interest to be overstated.

To understand why, it is useful to note that U.S. options exchanges distinguish between transactions, on the one hand, and transfers, on the other. Transactions, which involve a change in beneficial ownership, are, with limited exceptions, required to be effected on an options exchange and exposed to the price competition of the exchange. This competition serves to validate the prices at which the transactions occur. Transfers, by contrast, often occur “off-exchange” through the submission of entries to clearing firms and clearing houses. Transfers can result in either a change in beneficial ownership (“change transfers”) or no change in beneficial

ownership (“no-change transfers”). A change transfer may occur, for example, where a joint account is dissolved and one of the account holders assumes the positions of the joint account. A no-change transfer might occur where a position is moved between two accounts under common ownership and control for risk management purposes. This Petition concerns CBOE’s proposal to amend CBOE Rule 6.49A to substantially eliminate the ability of CBOE members to initiate certain off-exchange, no-change transfers.

Specifically, Rule 6.49A as amended would:

- prevent no-change transfers between separate trading accounts under the same beneficial ownership;
- not only severely limit no-change transfers but also prohibit an entity from relying on permitted no-change transfers “repeatedly or routinely in circumvention of the normal auction market process,” even though no-change transfers can serve on a regular basis to reduce and manage risk, and even though it would be incongruous and impractical to expose such transfers to the normal auction process (which would result in market distorting wash trades);
- generally prohibit transfers from “netting” (i.e., offsetting long positions against short positions in the same options series), even when the positions are economically flat and maintaining them separately overstates open interest and diminishes prudent risk management; and
- selectively and discriminatorily permit netting in connection with off-exchange, no-change transfers where firms utilize a centralized universal clearing account but not where firms use standard clearing accounts.

The amendments constitute a fundamental departure from the underlying premise of CBOE Rule 6.49 and Rule 6.49A as originally approved by the Commission. Simply put, no-change transfers were not understood to be “transactions” required to be effected on the floor under Rule 6.49, and they therefore had no need for an exception from that requirement under Rule 6.49A to be initiated off-exchange. In the absence of this understanding, the Order approving the amendments by delegated authority is factually and legally erroneous. In particular, the Order errs:

1. because CBOE has neither justified nor explained its departure from the foundational premise of Rules 6.49 and 6.49A as previously described by CBOE and approved by the Commission, which is that Rule 6.49 does not reach no-change transfers, and that firms therefore do not need relief via Rule 6.49A to initiate such transfers off-exchange;
2. because the amendments would unfairly discriminate against market participants using standard clearing accounts in favor of participants using a universal clearing account;
3. because the amendments either encourage pre-arranged wash sale trading or cause open interest to be overstated, thereby having a distortive effect on options markets and options market data; and
4. because the amendments would tend to impede efficient risk management by market participants, thereby reducing liquidity and increasing transaction costs for options investors.

As described more fully below, CBOE’s departure from the straightforward and intuitive premise of Rules 6.49 and 6.49A has unfolded in recent years in an ad hoc manner without any

Commission review or approval. Now, with the approval by delegated authority of the amendments presently at issue, Rule 6.49A would become unmoored from its intended scope and devoid of its interpretive coherence. Moreover, CBOE has not addressed the multiple, negative consequences that would result from the amended rule—the way it would undermine competition, fairness, market integrity, and investor protection (i) by selectively and arbitrarily impacting the business of options market participants, (ii) by encouraging the submission of distorted price, volume, and open interest data to the Exchange, and (iii) by adding unnecessary costs on investors through the imposition of impediments to effective risk management by options market participants. For these reasons, set forth more fully below, SIG respectfully requests that the Commission grant this Petition and review the determinations made by delegated authority.

Factual Background

A. SIG's Business

SIG is one of the two largest options market makers in the United States. The firm makes markets in nearly all the approximately one million options series listed on the U.S. options exchanges and is recognized globally as a leading participant in the derivatives marketplace. The firm commits capital and provides liquidity in almost every exchange-listed options market, including equity, commodity, energy, exchange-traded fund, index, and futures options markets.

SIG operates through a number of wholly owned broker-dealers that often trade in the same options classes across multiple markets. The ultimate beneficial ownership of each of the SIG broker-dealers is virtually the same for these purposes. Thus, SIG naturally considers the positions held by all of its entities and traders in combination when assessing and managing the risk created by those positions. Common risk management of those related positions is

important not only from organizational and regulatory points of view, but also to firms representing public investors that rely on SIG liquidity in the options market.

Operationally, a portion of the options trades entered into by SIG's various broker-dealers clear through uniquely identified accounts. Such "standard account" clearing arrangements are in contrast to "universal account" clearing arrangements under which multiple traders clear their trades through a common clearing account wherein positions from all trades are held collectively. Both types of clearing arrangements are widely used within the industry for listed options. Both are recognized as acceptable account types, and neither has any effect on the beneficial ownership of the positions held in the accounts. Standard accounts are considered well-suited to compete in a host of circumstances, and thereby often allow market makers to better provide liquidity and benefit the market.

B. History of CBOE Regulation of Off-Exchange Transfers

CBOE Rule 6.49 provides that "no Trading Permit Holder acting as principal or agent may effect transactions in any class of options contracts listed on the Exchange for a premium in excess of \$1.00 other than (i) on the Exchange, (ii) on another exchange on which such option contracts are listed and traded, or (iii) in the over-the-counter market [in certain circumstances] . . . unless the Trading Permit Holder has attempted to execute the transactions on the floor of the Exchange and has reasonably ascertained that it may be executed at a better price off the floor." CBOE Rule 6.49 dates to the mid-1970s,¹ with minor changes to comply with SEC Rule 19c-1 and to accommodate over-the-counter trading.²

¹ See Securities Exchange Act Release No. 12165 (Mar. 4, 1976), 41 FR 10498 (Mar. 11, 1976).

² See Securities Exchange Act Release No. 22453 (Sept. 24, 1985), 50 FR 40095 (Oct. 1, 1985).

In 1995, CBOE proposed Rule 6.49A to codify certain exceptions to Rule 6.49's general policy requiring transactions to be executed on the Exchange.³ These exceptions included:

- (i) the dissolution of a joint account in which the remaining member assumes the positions of the joint account;
- (ii) the dissolution of a corporation or partnership in which a former nominee of the corporation or partnership (i.e., a shareholder or partner, respectively) assumes the positions;
- (iii) the transfer of positions as part of a member's capital contribution to a new joint account, partnership, or corporation;
- (iv) the donation of positions to a not-for-profit corporation;
- (v) the gifting of positions to minors; and
- (vi) a merger or acquisition where continuity of ownership or management results.

CBOE provided important historical context for Rule 6.49 in proposing Rule 6.49A when it referred to what it described as its “long-standing policy” of “prohibiting transfers of option positions between accounts, individuals, or entities *where a change in beneficial ownership would result.*”⁴ CBOE’s proposing language thus made clear that Rule 6.49A meant to address only change transfers and that under the longstanding policy, Rule 6.49 did not prohibit no-change transfers. The Commission recited the same language in its order approving the rule.⁵ Indeed, Rule 6.49A on its face was meant to deal with instances that were entirely distinguishable from no-change transfers—it addressed situations where some change in beneficial ownership would or could occur. Importantly, these situations involved economically distinct parties, which raised the question of whether the price at which they would occur should be exposed to the exchange auction process. On the other hand, the practical difficulty of effectuating exposure in these situations favored allowing these change transfers to occur off-exchange pursuant to limited exceptions.

³ See Securities Exchange Act Release No. 36241 (Sept. 15, 1995), 60 FR 49430 (Sept. 25, 1995).

⁴ *Id.* at 49430 (emphasis added).

⁵ See Securities Exchange Act Release No. 36647 (Dec. 28, 1995), 61 FR 566, 566 (Jan. 8, 1996).

The situation where an owner of a large, bulk position was undergoing a change in business and wished either to sell its positions to an arranged buyer at an aggregate price (thereby avoiding expensive and fragmented sales of a market-disrupting nature) or to bring in a new financial backer or partner illustrates Rule 6.49A's intended focus as originally approved. In either case, the bulk transfer would involve a complete or partial change in beneficial ownership. Prior to the adoption of Rule 6.49A, the only permissible off-exchange transfers were those that resulted in no change in beneficial ownership. There were no restrictions at that time—formal or informal—regarding purpose, circumstances, frequency, or netting on off-exchange, no-change transfers. The point of Rule 6.49A was to relax the longstanding prohibition on off-exchange, change transfers by creating exceptions that would permit transfers involving some degree of change in beneficial ownership to occur off-exchange in some instances, while at the same time permitting certain other change transfers to occur on the exchange.

Between the time the Commission approved Rule 6.49A and the filing of the amendments presently at issue, the Exchange never filed any proposal with the Commission to alter the longstanding policy of permitting off-exchange, no-change transfers, nor the well-understood scope of Rules 6.49 and 6.49A, which limited change transfers but did not reach no-change transfers. Over time, however, CBOE took certain ad hoc positions that purported to reinterpret the Exchange's longstanding policy. In 2003, CBOE issued Regulatory Circular RG 03-62 (the "Circular"),⁶ which contained written interpretive guidance dealing with the scope of Rule 6.49A. The Circular was not submitted to the Commission for approval. In the Circular,

⁶ See CBOE Regulatory Circular RG03-62 (July 24, 2003), *available at* http://www.cboe.com/framed/pdf/framed?content=/publish/RegCir/RG03-062.pdf§ion=SEC_ABOUT_CBOE_BOD&title=RG03-062+Transfer+of+Positions.

CBOE reiterated the types of transfers excepted from the prohibition in Rule 6.49, again focusing on change transfers—transactions that involve some form of change in beneficial ownership. But for the first time, CBOE asserted that *any* off-exchange transfer that resulted in a netting of open interest was prohibited under Rule 6.49A. The new netting condition, in other words, was imposed without regard to whether the transfer was a change transfer or a no-change transfer. CBOE provided no textual or policy basis for purporting to impose the netting restriction on no-change transfers. The Circular also confusingly stated, under the topic heading “Transfers that result in no change in beneficial ownership,” that a “transfer of positions between affiliated accounts in connection with a business reorganization where continuity of ownership results is permissible.” Former CBOE staff who were designated as contact persons in the Circular have advised SIG that the reference to reorganizations was merely an illustrative example in response to questions at the time about reorganizations, and was in no way a limitation on other off-exchange, no-change transfers.

Since issuing the Circular, CBOE staff, through informal guidance, has sought to expand the scope of Rule 6.49 and Rule 6.49A on several occasions. CBOE, however, has not submitted these informal interpretations to the Commission for approval (or even to CBOE membership or the public for comment), and has not explained how they are consistent with—let alone reasonably implied by—the previously promulgated rules or sound as a matter of policy.

With its most recent amendment to Rule 6.49A, CBOE states without supporting analysis or authority that “[c]urrent Rule 6.49A(a)(1) lists the circumstances in which Trading Permit Holders may transfer their positions off the floor.” The amendments effectively abandon the

plain and intuitive limitation on scope contained in Rule 6.49A as originally approved by the Commission, and now seek to selectively *prohibit* many no-change transfers.⁷

SIG Seeks Review of the Staff's Order as an Aggrieved Party

Under Rule 430 of the SEC Rules of Practice, “any person aggrieved by Staff action taken by delegated authority may seek Commission review of that action.” SIG is aggrieved by the Order approving the proposed rule change.⁸ SIG is an options market maker in numerous options classes that would be financially impacted by the proposed rule change, including by incurring unreasonable and discriminatory costs due to its use of standard clearing accounts—costs not incurred by firms using only universal clearing accounts. Moreover, like other market participants, SIG is harmed by the distortion of market data resulting from the prearranged trades that are encouraged by the Rule 6.49A amendments, and by the overstatement of open interest data that would result from the amendments. SIG has duly complied with the procedural requirements of Rule 430(b) by filing on October 23, 2018 a timely Notice of Intention to Petition for Review, and filing this Petition within five days thereafter, as computed in accordance with Rule 160(a) of the SEC's Rules of Practice.⁹

The Applicable Standards for Granting Review and Demand for Relief

Rule 431(b)(2) of the SEC Rules of Practice sets forth the standards for the Commission's decision to grant review pursuant to a Rule 430 petition. Namely, the Commission “shall consider the factors set forth in Rule 411(b)(2).”¹⁰ And Rule 411(b)(2)

⁷ See *infra* at 10-12.

⁸ SIG submitted a comment letter in opposition to the proposed amendments to Rule 6.49A before it became aware that the proposal had been approved by delegated authority. Now, with the delegated approval of CBOE's proposed change, SIG feels compelled to submit this Petition.

⁹ 17 CFR § 201.160(a).

¹⁰ 17 CFR § 201.431(b)(2).

requires the Commission to consider whether the petition for review makes a reasonable showing that (i) a prejudicial error was committed in the conduct of the proceeding; or (ii) the decision embodies: (A) a finding or conclusion of material fact that is clearly erroneous; (B) a conclusion of law that is erroneous; or (C) an exercise of discretion or decision of law or policy that is important and that the Commission should review.¹¹

I. The Order Approving CBOE's Proposal was Premised on Errors of Fact and Law

A. CBOE's Proposed Amendment to Rule 6.49A Prohibiting Many Off-Exchange, No-Change Transfers is an Incongruous and Unsupported Expansion of the Scope of the Rule as Originally Approved by the Commission.

As detailed above,¹² CBOE's efforts to regulate off-exchange, no-change transfers have morphed over time from the Commission's approval of Rule 6.49A in 1995 through to the amendments recently approved by delegated authority that are the subject of this Petition. The unsupported alteration of the rule's scope as interpreted by CBOE is best demonstrated by referring to the scope of Rule 6.49A as originally approved by the Commission, as interpreted in the unapproved 2003 CBOE Circular, and as reflected in the amendments that are the subject of this Petition.

As noted, CBOE's own language in proposing Rule 6.49A in 1995 (language that the Commission repeated in its order approving that proposal) best reveals the context in which the rule was proposed. CBOE began its introduction to the proposed rule by setting forth its "long-standing policy of prohibiting transfers of option positions between accounts, individuals, or entities *where a change in beneficial ownership would result.*"¹³ Moreover, the text, logic, and

¹¹ 17 CFR § 201.411(b)(2).

¹² See *supra* at 5-9.

¹³ See Securities Exchange Act Release No. 36241 (Sept. 15, 1995), 60 FR 49430, 49430 (Sept. 25, 1995); Securities Exchange Act Release No. 36647 (Dec. 28, 1995), 61 FR 566, 566 (Jan. 8, 1996) (emphasis added).

structure of Rule 6.49A dealt with change transfers, establishing a mechanism to expose some change transfers to CBOE's auction mechanism and providing exemptions from the long-standing prohibition for other specified change transfers. The reason for the regulatory focus is fairly straightforward—change transfers involve economically distinct parties reflecting genuine supply and demand, whereas no-change transfers merely move positions from one's left pocket to one's right pocket without any reflection of bona fide supply and demand.

Indeed, it would defy common sense for the “some or all” change of beneficial ownership transfers delineated in Rule 6.49A to occur off-exchange, but to prohibit off-exchange, no-change transfers save for a narrow exception for reorganizations. It would simply be inappropriate for the Exchange to force the movement of fully owned positions under common beneficial ownership from one wholly owned account to another to be effected on the Exchange and face execution fees, paying the spread by buying on offers and selling on bids, and possible break-up by other market participants.

Another ill-considered aspect of the Rule 6.49A amendments stems from the broad prohibition on netting. A significant consideration behind Rule 6.49A is the facilitation of bulk transfers of positions held by distressed firms exiting the market. The netting prohibition, however, devalues the positions to potential bidders who may hold offsetting positions and would otherwise be forced to carry both long and short positions in the same options. The result would be that the bids offered to a large troubled firm would cover only part of the positions sought to be transferred. The end result is that the large troubled firm would be prevented from accessing the most favorable liquidity in stressful markets, and that a speedy resolution of the liquidity event would be delayed because of regulatory obstacles.

CBOE may style its amendment to Rule 6.49A as a “codification” confirming longstanding guidance, but the reality is otherwise. As described, the Exchange’s seeming expansion of permissible off-exchange transfers actually is a limitation of the CBOE’s longstanding policy allowing off-exchange, no-change transfers between accounts within the same or affiliated persons. The proposed expansion of the rule beyond its intended scope would lead to troubling, unintended, and as yet unexamined consequences. CBOE has made no effort to justify the expanded scope it proposes or the consequences that would result. The approval by delegated authority of the amendments was therefore in error.

B. CBOE Fails to Address How the Disparate Treatment of Broker-Dealers Utilizing Standard Clearing Accounts as Opposed to Universal Clearing Accounts is Consistent with the Requirements of the Exchange Act.

The proposed rule unfairly discriminates against market participants using standard clearing accounts in favor of participants using universal clearing accounts, which renders erroneous the Order’s finding that the amendment is not designed to permit unfair discrimination. The amended rule imposes an undue burden on competition between firms that are in all material respects similarly situated.

As noted earlier, listed options trades can be cleared either through standard clearing accounts that hold the positions of just one market maker (or other trading unit) or through universal clearing accounts that hold the positions of multiple market makers or other trading units on a collective basis. SIG (like many other firms) uses standard clearing accounts. Some firms use universal clearing accounts to a greater extent. The difference between the two is a matter of accounting structure, not a difference in beneficial ownership that bears on the regulation of position transfers.

The newly approved Rule 6.49A discriminates against the use of standard clearing accounts in that it permits off-exchange transfers between separate exchange-specific market makers that clear into a universal clearing account, but not between market makers that clear into standard clearing accounts. It also discriminates by the prohibition, in Rule 6.49A(b)(1), against netting one position against another when making an off-exchange transfer unless permitted by Rule 6.49A(b)(2), which permits netting for off-exchange transfers between a Trading Permit Holder's separate market maker accounts for transactions in multiply listed options on different exchanges that cannot clear into the same Options Clearing Corporation ("OCC") market maker account, provided the positions are transferred into a universal clearing account at the OCC.¹⁴

In doing so, the new rule enables firms using universal clearing accounts to manage risk by making off-exchange transfers of positions among different trading units and netting such positions where they are offsetting, but prohibits firms using standard clearing accounts from managing risk in that manner. Neither CBOE's proposal nor the Commission's Order explains why the exception is limited to transfers into, and netting within, universal clearing accounts or how its disparate treatment for standard and universal clearing accounts is consistent with Exchange Act Section 6(b)(5)'s requirement that the rules of an exchange not be designed to "permit unfair discrimination between customers, issuers, brokers, or dealers" or Section

¹⁴ Specifically, newly adopted Rule 6.49(b) provides as follows: "(1) Unless otherwise permitted by subparagraph (b)(2) or paragraph (f), when effecting an off-floor transfer pursuant to paragraph (a), no position may net against another position ("netting"), and no position transfer may result in preferential margin or haircut treatment. (2) Notwithstanding subparagraph (b)(1) above, netting is permitted for off-floor transfers on behalf of a Market-Maker account for transactions in multiply listed options series on different options exchanges, but only if the Market-Maker nominees are trading for the same Trading Permit Holder organization and the options transactions on the different options exchanges clear into separate exchange-specific accounts because they cannot clear into the same Market-Maker account at the Clearing Corporation. In such instances, all Market-Maker positions in the exchange-specific accounts for the multiply listed class may be automatically transferred on their trade date into one universal Market-Maker account at the Clearing Corporation."

6(b)(8)'s requirement that the rules of an exchange not impose any unnecessary burden on competition.¹⁵

Permitting firms using universal clearing accounts to make off-exchange transfers of positions in multiply listed options without allowing firms using standard clearing accounts to do the same creates an uneven playing field to the unfair detriment of the latter. The extent of that detriment is most pronounced for firms that use standard clearing accounts to the greatest degree and puts them at a competitive disadvantage to firms that use universal clearing accounts exclusively or otherwise more widely. Neither the Commission nor the Exchange, however, has adopted any formal policy to favor universal clearing accounts over standard clearing accounts, and there is no reason to do so. The beneficial ownership of the positions is independent of whether they are distributed across multiple standard clearing accounts or held together in one universal clearing account. The arbitrarily selective netting restriction artificially limits the ability of firms using standard clearing accounts to manage position risk efficiently, causes them to incur unnecessary carrying costs, and thereby restricts their ability to provide liquidity, while firms using universal clearing accounts are free of such burdens. That imbalance is unjustified, and it is inconsistent with the requirements of Sections 6(b)(5) and 6(b)(8) of the Exchange Act.

C. The Proposed Rule Would Have a Distortive Effect on Options Market Data.

The proposed rule would distort market data in one of two ways. If firms react to the prohibition of off-exchange, no-change transfers by attempting to utilize the floor auction process to consummate the transfer, the result would be exactly what the Exchange's and other self-regulatory organizations' wash trading prohibitions are designed to prevent: the injection into the marketplace of price and volume information that does not reflect genuine trading

¹⁵ See 15 U.S.C. §§ 78f(b)(5), (b)(8).

interest. If firms forgo no-change transfers, the result would be the artificial inflation of open interest in the marketplace by prohibiting off-exchange netting or offsetting of options positions in separate accounts of a single beneficial owner. CBOE's proposal fails to address these distortive effects on market data, which contravene the Exchange Act's requirement that exchange rules "prevent fraudulent and manipulative acts and practices," "promote just and equitable principles of trade," "remove impediments to and perfect the mechanism of a free and open market," and "protect investors and the public interest."¹⁶ As a result, the Order's finding that the change is consistent with Section 6(b)(5) of the Exchange Act is unsupported and erroneous.

By curtailing no-change transfers, the amendments to Rule 6.49A would create pressure on firms to transfer internal positions by sending trades to options exchanges for execution in a prearranged fashion. This would in essence create wash trades involving no change in beneficial ownership. CBOE, through a regulatory interpretation in the 1980s, defined wash trading as trading between related accounts with greater than 10% common ownership.¹⁷ CBOE has stated that any violation of the prohibition against wash trading would be a violation of Rule 4.1 regarding just and equitable principles of trade.¹⁸ As the Commission is aware, wash trades inject distortive information about supply and demand into the market.

Large, offsetting orders entered into the marketplace would provide artificial signals about existing interest in the particular option. The same would be the case if the orders were sent to separate exchanges for execution. In the case of options, they would also inflate

¹⁶ See 15 U.S.C. §78f(b)(5).

¹⁷ See Securities Exchange Act Release No. 43984 (Feb. 20, 2001), 66 FR 12574, 12575 (Feb. 27, 2001).

¹⁸ *Id.*

volatility, upon which data investors rely in valuing options and making trading decisions. This distortion of market data would be exacerbated by the repeated and routine frequency of such trades as options market makers seek to efficiently manage the risk of their positions (which is a prominent regulatory goal) to best provide liquidity to the public. Requiring wash trades as the means to transfer positions would artificially inflate transaction data, providing market participants with a false impression of activity in a particular option. It could also skew options pricing and distort the pricing relationship between an option and its underlying stock.

In conversations with SIG, CBOE staff paradoxically advised that, under their current guidance, no-change transfers are not allowed off-exchange because the movement from one account to another would make it a change in beneficial ownership, but that effecting the same position movement via an Exchange cross transaction would not be allowed because there would be *no change in beneficial ownership*. Staff suggested that a workaround would be to offset positions by conducting two separate transactions, one in the morning and the other later in the day. That suggestion is not credible, as it would pose untenable risk to a firm and would also exacerbate the distortive effect of wash trades on options market data. First, this approach would place a firm at huge economic risk of market movement between the time of the two transactions. Moreover, regardless of market movement, the cost associated with crossing the spread to offset positions would be prohibitively expensive, given the nature of the transactions as a mere transfer. Finally, this approach would produce two transactions that are not rooted in the natural supply and demand of the options market, thus giving a false impression of bona fide activity in a particular option.

The alternative to prearranged trades is maintaining offsetting options positions in separate accounts. The netting restriction on no-change transfers would thus artificially inflate

open interest in options, upon which data investors and the public rely. If a beneficial owner is long an option series in one account and short the same series in another account, but does not have a means to collapse those offsetting positions without effecting cost-prohibitive prearranged trades, open interest figures at the OCC would be artificially inflated on both the long and short sides to the detriment of investors and the public.

The tendency of Rule 6.49A's amendments to undermine the quality of options market data renders erroneous the Order's finding that the amendments are consistent with the requirements of Section 6(b)(5) of the Exchange Act.

D. The Proposed Rule Would Harm the Public Interest by Impeding Effective Risk Management and Thereby Causing Increased Transaction Costs and Wider Spreads

Despite the inherent logic of allowing offsetting and hedging positions to be combined to reduce outstanding risk and carrying costs, CBOE's proposal unreasonably prohibits the efficient risk management of such positions through no-change transfers. Instead, CBOE's proposal effectively forces options market makers utilizing standard clearing accounts (assuming they decline to submit no-change transfers to the exchange for consummation), to maintain offsetting and hedging positions in separate accounts, thereby resulting in uncoordinated risk management efforts even intrafirm. The Rule's effect of impeding efficient risk management by market makers will result in an increase in transaction costs for options investors through wider quotes without any corresponding benefit.¹⁹ As a result, the Order's finding that the proposal would "protect investors and the public interest" is unsupported and erroneous. Accordingly, the

¹⁹ Options market makers provide roughly 90% of the displayed liquidity in listed options, and therefore play a crucial role in ensuring an adequate level of liquidity on, and the efficient operation of, the options market.

Order's determination that the amendments to Rule 6.49A were consistent with Section 6(b)(5) and that they serve investor protection and the public interest was erroneous.

II. The Order Represents an Exercise of Discretion and a Decision of Policy that is Important and that the Commission Should Review

As demonstrated above, the Order approving by delegated authority the amendments to Rule 6.49A reflects a broad exercise of discretion by the Staff, and multiple important decisions of policy that the Commission should review.

First, the amended rule will present CBOE members seeking to engage in no-change, risk management transfers with a needless conundrum: they can either submit their internal, no-change transfers to CBOE as "transactions" even though their firm is on both sides of the trade (either in single transactions or legging into the transition via multiple transactions), or they can decline to manage the risk inherent in their open and fully owned positions. As originally understood and approved by the Commission, Rule 6.49A presented no such dilemmas because it plainly permitted off-exchange, no-change transfers. There is, respectfully, no good reason for this policy change.

Second, the amended rule would create a significant competitive imbalance between SIG and other options market makers by disadvantaging those, like SIG, that utilize standard clearing accounts, and benefitting those that use universal clearing accounts to a greater degree.

Finally, the amended rule, by impeding the effective use of no-change transfers for risk management purposes, would widen market maker spreads and increase the transaction costs of options investors.

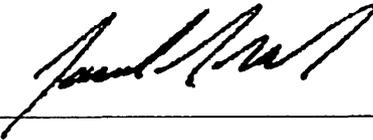
For these important policy reasons, the Commission should review the Order by delegated authority approving the amendments to CBOE Rule 6.49A.

Conclusion

For the reasons set forth above, CBOE's proposal warrants Commission review because the Order contains clear errors of fact and law in finding that CBOE's proposal is consistent with Section 6 of the Exchange Act and because the Order involves an important exercise of discretion by the Staff and important policy decisions. SIG respectfully requests that the Commission grant this Petition to review the Order.

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Respectfully submitted on behalf of
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