



8011-01
SECURITIES AND EXCHANGE COMMISSION
[Release No. 34-87765; File No. SR-CBOE-2019-117]

Self-Regulatory Organizations; Cboe Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Amend Rule 5.72 to Eliminate the Requirement that Leg Prices be Submitted Prior to the Time a Complex FLEX Order is Represented in an Open Outcry FLEX Auction
December 16, 2019.

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 December 6, 2019, 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 and II below, which Items have been prepared by the Exchange. The Exchange filed the proposal as a “non-controversial” proposed rule change pursuant to Section 19(b)(3)(A)(iii) of the Act³ and Rule 19b-4(f)(6) thereunder.⁴ 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

Cboe Exchange, Inc. (the “Exchange” or “Cboe Options”) proposes to amend Rule 5.72.

The text of the proposed rule change is provided below.

(additions are *italics*; deletions are [bracketed])

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Rules of Cboe Exchange, Inc.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A)(iii).

⁴ 17 CFR 240.19b-4(f)(6).

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Rule 5.72. FLEX Trading

(a) No change.

(b) *FLEX Orders*. A FLEX Option series is only eligible for trading if a FLEX Trader (the “Submitting FLEX Trader”) (i) submits a FLEX Order for that series into an electronic FLEX Auction pursuant to paragraph (c) of this Rule, (ii) represents the FLEX Order in an open outcry FLEX Auction pursuant to paragraph (d) of this Rule, or (iii) submits the FLEX Order to a FLEX AIM or SAM Auction pursuant to Rule 5.73 or 5.74, respectively.

(1) No change.

(2) *Complex FLEX Order*. A FLEX Order for a FLEX Option complex strategy submitted to the System must satisfy the criteria for a complex FLEX Order set forth in Rule 5.70(b) and include size, side of the market, and a net debit or credit price[, and a bid or offer price for each leg of the FLEX Order, which leg prices must add together to equal the net price]. Additionally, each leg of the FLEX Option complex strategy must include all terms for a FLEX Option series set forth in Rule 4.21 (including that a non-FLEX Option series with identical terms is not listed for trading), subject to the order entry requirements set forth in Rule 5.7.

(A) A complex FLEX Order submitted into the System for an electronic FLEX Auction pursuant to paragraph (c) below must include a bid or offer price for each leg, which leg prices must add together to equal the net price.

(B) A complex FLEX Order submitted into the System prior to representation in an open outcry FLEX Auction pursuant to paragraph (d) below may include a bid or offer price on one or more of the legs (subject to a FLEX Trader’s responsibilities pursuant to Rule 5.91 and Chapter 9). The execution leg prices must be entered or modified, as necessary, via PAR following execution of the order, which prices must add together to equal the net execution price.

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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 Rule 5.72(b) regarding the information required in a FLEX Order⁵ for a FLEX Option complex strategy submitted to the System for execution in an open outcry FLEX Auction.⁶ A FLEX Option series is only eligible for trading if a FLEX Trader (the “Submitting FLEX Trader”) submits a FLEX Order for that series into an electronic FLEX Auction pursuant to Rule 5.72(c) or represents the FLEX Order in an open outcry FLEX Auction pursuant to Rule 5.72(d).⁷ Currently, Rule 5.72(b) provides that a FLEX Order for a FLEX Option complex strategy submitted to the System must satisfy the criteria for a complex FLEX Order set forth in Rule 5.70(b)⁸ and include size, side of the market, a net debit or credit price, and a bid or offer price for each leg of the FLEX Order, which leg prices must add together to equal that net price. This applies to complex FLEX Orders submitted for both electronic and open outcry execution.

⁵ A “FLEX Order” is an order submitted in a FLEX Option. See Rule 5.70(a). A “FLEX Option” means a flexible exchange option. See Rule 1.1.

⁶ See Rule 5.72(d) for a description of the open outcry FLEX Auction process.

⁷ See Rule 5.72(b). A FLEX Option series may also be eligible for trading if the Submitting FLEX Trader submits the FLEX Order to a FLEX Automated Improvement Mechanism auction or FLEX Solicitation Auction Mechanism auction pursuant to Rule 5.73 or 5.74, respectively.

⁸ Rule 5.70(b) requires each leg of a complex FLEX Order to: (1) be for a FLEX Option series authorized for FLEX trading with the same underlying equity security or index; (2) must have the same exercise style (American or European); and (3) for a FLEX Index Option, may have a different settlement type (a.m.-settled or p.m.-settled), except each leg must have the same settlement type if designated as Asian-settled or Cliquet-settled.

The proposed rule change removes the requirement that a FLEX Order submitted into the System prior to representation in an open outcry FLEX Auction include leg prices at the time of order submission.⁹ Specifically, proposed Rule 5.72(b)(2)(B) states a complex FLEX Order submitted into the System prior to representation in an open outcry FLEX Auction pursuant to paragraph (d) of Rule 5.72 may include a bid or offer price on one or more of the legs (subject to a FLEX Trader's responsibilities pursuant to Rule 5.91 (which describes responsibilities of a floor broker) and Chapter 9 (which describes obligations on Trading Permit Holders that do business with the public)). The execution leg prices must be entered or modified, as necessary, via PAR following execution of the order, which prices must add together to equal the net execution price.

When a floor broker (which is the Submitting FLEX Trader with respect to open outcry FLEX trading) receives an order from a customer, the floor broker must systematize the terms of that order, including any limit price (which is the net price with respect to a complex order).¹⁰ As noted above, current Rule 5.72(b)(2) requires a Submitting FLEX Trader (i.e., a floor broker with

⁹ The proposed rule change has no impact on complex FLEX Orders submitted for electronic execution. The proposed rule change moves the requirement that a complex FLEX Order submitted into the System for an electronic FLEX Auction pursuant to Rule 5.72(c) include a bid or offer price for each leg, which leg prices must add together to equal the net price, to proposed Rule 5.72(b)(2)(A).

¹⁰ See Rule 5.7(f) (which requires systemization of the terms of an order, which would include the limit price if a limit order); see also Rule 5.6(b) (which defines a "limit order" as an order to buy or sell a stated number of option contracts at a specified price or better). Customers that trade complex limit orders generally only provide a limit price for the net price, as they are ultimately looking for execution of the entire package to occur at a certain price (or better). However, it is possible (although uncommon) that a customer may provide a limit price for one or more of the legs, which the floor broker would also be required to systematize upon entry as a term of the order. In addition to the definition of a limit order, which may not trade at a price worse than the limit price, floor brokers are required to use due diligence to execute an order at the best prices available, as well as in accordance with the rules (including the definition of a limit order) and general floor broker responsibilities. See Rule 5.91(a); see also Rule 5.91(c) (which provides that an order entrusted to a floor broker is considered not held, which (as defined in Rule 5.6(c)) gives a floor broker discretion as to the price and time at which an order is to be executed, subject to a client's specified instruction).

respect to open outcry trading) to systematize prices of all legs of a complex order upon submission. The Exchange imposed this requirement for both electronic and open outcry FLEX orders for consistency within the Rules.

Additionally, the Exchange believed this requirement to be appropriate due to the lack of electronic leg markets in FLEX options. In the non-FLEX market, there is no requirement to systematize leg prices upon submission of a complex order. In a non-FLEX market, there is a book and a national best bid or offer, and as a result, the System has a benchmark to use to determine execution leg prices based on the net execution price of a complex order (which leg prices may not be outside of the best prices of orders and quotes in the book for those legs). This is not the case in the FLEX market, in which there is no market in the leg series of complex orders that the System can use to calculate appropriate execution prices of the legs of a complex strategy (for which there are countless combinations of prices). Therefore, the Exchange believed requiring the leg prices to be input upon submission of a complex FLEX order would provide the System with this benchmark information to use when determining leg execution prices based on the net execution price.

Because of the automatic execution of an electronic FLEX order following the electronic FLEX auction, which auction is based on the net execution price, the Exchange continues to believe the requirement to input leg prices upon submission of an order to an electronic FLEX auction is appropriate. However, in open outcry FLEX trading (as well as open outcry non-FLEX trading), the FLEX auction process functions as a price negotiation through which the net execution price, as well as the leg execution prices (that add up to that net execution price) are determined. Since the open outcry FLEX Auction process can be used to determine leg prices for a complex FLEX order after the parties agree to a net execution price, the Exchange believes it is reasonable to permit a Submitting FLEX Trader to input leg prices into the System either upon submission of a complex

FLEX Order (and adjusted as necessary following execution), or only following execution. If a Submitting FLEX Trader includes leg prices in a complex FLEX Order upon submission of the order, the execution prices of those legs may be modified following the auction (subject to any limit price for a leg as instructed by a customer), as long as they add up to the net execution price.

The proposed rule change permits a Submitting FLEX Trader to continue to input those leg prices upon submission of the order and modify them as necessary following execution, or input them after execution. The proposed rule change is not modifying how complex FLEX Orders may be executed in open outcry, or the execution information that must be provided to the Exchange. Any leg prices input upon systematization of an order are visible only to the FLEX Trader on its PAR workstation. Prior to representing a complex order to the trading crowd, a FLEX Trader will generally request a market from the trading crowd. FLEX Traders (generally market-makers) in the trading crowd will respond with a market for the net price. Market-makers price the orders and the legs based on their own pricing models – they do not know the net limit price or the leg price of the systematized order, as a floor broker does not announce the leg prices when it represents the order on the trading floor. Once the crowd agrees on a net price, it then negotiates prices for the legs, which the Submitting FLEX Trader will input (or update, if applicable) into the order record on its PAR workstation. Therefore, whether a FLEX Trader inputs leg prices before an execution (and modifies them as necessary after execution to reflect floor negotiations during the open outcry auction (if necessary), or only inputs the execution leg prices after execution, has no impact on the open outcry FLEX auction or the prices at which FLEX complex orders (and the prices of the legs of those orders) trade. The proposed rule change is merely modifying the time at which FLEX Traders may provide the information to the Exchange.

The Exchange will issue an Exchange Notice announcing the implementation date for the proposed rule change, which date the Exchange expects to be within the next two weeks. This will permit the Exchange to implement the proposed rule change within its system and provide sufficient notice of the change and its related requirements to Trading Permit Holders.

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 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 remove impediments to and perfect the mechanism of a free and open market by providing Submitting FLEX Traders with the flexibility to input leg prices of complex strategies either upon entry of a complex FLEX Order or following execution. The Exchange believes this may lead to more efficient open

¹¹ 15 U.S.C. 78f(b).

¹² 15 U.S.C. 78f(b)(5).

¹³ Id.

outcry executions on behalf of a floor broker's customer, as a Submitting FLEX Trader will not be required to take the time to input leg prices upon submission of the order and then modify them after execution to reflect these negotiations, which ultimately benefits investors (as further discussed below). As noted above, because any leg prices of a complex FLEX order input upon systematization are only known to the Submitting FLEX Trader and not known to any other person in the trading crowd, the Exchange believes the proposed rule change will have no impact on the manner in which complex FLEX Orders are negotiated and executed in open outcry. The proposed rule change is not modifying how complex FLEX Orders may be executed in open outcry, or the information that Submitting FLEX Traders must provide to the Exchange. The proposed rule change is merely modifying the time at which Submitting FLEX Traders may provide certain information to the Exchange.

The Exchange believes the proposed rule change will protect investors, because it will permit a floor broker to request a market and execute a customer's order in open outcry in a more timely fashion. FLEX orders may include a substantial number of legs (they regularly include more than ten legs, but may include up to 100 legs). Inputting leg prices for a large number of legs may be a time-consuming exercise (and as noted above, it is ultimately unnecessary prior to an open outcry FLEX auction¹⁴ given the negotiations that occur during such an auction), which may delay execution of the customer's order and potentially miss an opportunity for execution at prices based on then-current market conditions. While the proposed rule change has virtually no impact on other members of the trading crowd, the proposed rule change provides a floor broker with flexibility that may result in a timelier execution of its customer's FLEX order.

¹⁴ This is subject to a floor broker's general obligation to adhere to its customers' instructions. See supra note 10.

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

The Exchange 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. The Exchange does not believe that the proposed rule change will impose any burden on intramarket competition that is not necessary or appropriate in furtherance of the purposes of the Act, because it will apply to all Submitting FLEX Traders that represent complex FLEX Orders (i.e., floor brokers) in open outcry in the same manner. All Submitting FLEX Traders will have the option to input leg prices on a complex FLEX Order upon submission of the order to an open outcry FLEX Auction, or following execution of that FLEX Order. As noted above, because the remainder of the trading crowd does not currently know the leg prices systematized by the Submitting FLEX Trader, the proposed rule change will have virtually no impact on other market participants. The proposed rule change is not modifying the information that FLEX Traders must provide to the Exchange – it is merely modifying the time at which FLEX Traders may provide the information to the Exchange. The Exchange believes applying the proposed rule change to open outcry FLEX auctions but not electronic FLEX auctions is reasonable given the ability for the trading crowd to negotiate the leg prices in open outcry, while the System has no ability to price the legs based on the net execution price without an electronic leg market.

The Exchange does not believe that the proposed rule change will impose any burden on intermarket competition that is not necessary or appropriate in furtherance of the purposes of the Act, because it relates solely to the timing of the input of leg prices of FLEX Orders that may be executed on the Exchange. The proposed rule change merely provides Submitting FLEX Traders with flexibility regarding when they may input leg prices for complex FLEX Orders submitted for open outcry execution – either upon submission of the order or following

execution of the order. The proposed rule change will have no impact on how, or the prices at which, a complex FLEX Order may execute in an open outcry FLEX Auction.

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁵ and Rule 19b-4(f)(6) thereunder.¹⁶

A proposed rule change filed pursuant to Rule 19b-4(f)(6) under the Act¹⁷ normally does not become operative for 30 days after the date of its filing. However, Rule 19b-4(f)(6)(iii)¹⁸ permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has requested that the Commission waive the 30-day operative delay so that the proposal may become operative upon filing. The Exchange stated that it believes, among other things, that waiver of the operative delay will permit FLEX Traders to take advantage of the proposed flexibility and the potential for more

¹⁵ 15 U.S.C. 78s(b)(3)(A).

¹⁶ 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6)(iii) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

¹⁷ 17 CFR 240.19b-4(f)(6).

¹⁸ 17 CFR 240.19b-4(f)(6)(iii).

efficient open outcry FLEX executions as soon as possible, which it believes will ultimately benefit customers of floor brokers.

The Commission believes that waiver of the operative delay is appropriate because, as the Exchange stated, the rule change is not modifying the information that a Submitting FLEX Trader must provide to Exchange, but only the time at which such information may be provided to the Exchange and is not changing the way a FLEX Order is executed in an open outcry FLEX auction. The rule proposal also makes clear that if one or more of the legs is submitted with a limit price the Submitting FLEX Trader must enter the leg prices upon entry of the terms of the order. For these reasons, the Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest. Accordingly, the Commission designates the proposed rule change to be operative upon filing.¹⁹

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission will institute proceedings to determine whether the proposed rule change should be approved or 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:

¹⁹ For purposes only of waiving the 30-day operative delay, the Commission also has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

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-2019-117 on the subject line.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, D.C. 20549-1090.

All submissions should refer to File Number SR-CBOE-2019-117. 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 the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to

make available publicly. All submissions should refer to File Number SR-CBOE-2019-117 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.²⁰

J. Matthew DeLesDernier,
Assistant Secretary.

²⁰ 17 CFR 200.30-3(a)(12).

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