SIG
SUSQUEHANNA

August 19, 2019

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

Re: File No. SR-CBOE-2019-035/Re No. 34-86400
Position Transfers

Dear Mr. Fields:

Susquehanna International Group, LLP ("SIG")[1] submits this letter in response to the position transfer rule proposal referenced above (the *"proposal")*, as amended,[2] relating to Rule 6.49A of the Cboe Exchange, Inc. ("CBOE" or the "Exchange"). We applaud the CBOE for initiating an effort to bring much needed uniformity for position transfers to all options exchanges. We disagree however with certain of the provisions in the *proposal* and believe more clarity is necessary to determine how the changes will impact public investors and other market participants. We thank the Securities and Exchange Commission ("SEC") for this opportunity to respond.

The *proposal* adds four new events to the list of exceptions in Rule 6.49A for off-floor transfers and codifies certain other guidance. Where the new exceptions speak of allowing transfers for bona fide errors and legal purposes relating to death and bankruptcy, the additions appear appropriate. Where they relate to transfers involving no material change of beneficial ownership ("*no change*" transfers), the additions appear overly restrictive. In particular, by restricting transfers between *no change* MM accounts using broadly defined separate account delineations, and coupling that with strict prohibitions on routine-use and netting (collectively, the "*restrictions*"), the *proposal* will unnecessarily and unreasonably restrict the ability of affiliated options market makers ("MMs") to perform risk-reducing *no change* transfers.

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[1] Susquehanna International Group, LLP affiliated companies have operated as market makers and brokers in the U.S. listed options market for over 30 years and currently participate in a significant percentage of daily options volume.
[2] Amendment No. 1 to the *proposal* was filed by the CBOE in a letter dated August 6, 2019.

As a related matter, we note the references to risk weighted asset ("RWA") transfers that were originally part of the *proposal* (and removed by Amendment No. 1) have been largely resubmitted in a new rule filing ("RWA filing").[3] The RWA filing provides proper justifications for fewer restrictions on *no change* transfers, which will help alleviate some of the above-noted concerns once the RWA filing is approved. In this regard, a larger benefit could be realized for market participants in general if the approach used by the Exchange for the RWA transfers was to be adopted for the present *proposal* and thereby made applicable to all *no change* transfers.

The Restrictions will hinder MM firms in efforts to manage position risk

The options industry relies heavily on MMs to provide broad levels of liquidity, and options MMs rely heavily on their risk management abilities to provide it. While the *proposal* does not fully address the means and complexities by which MM organizations manage the risk of providing liquidity in options, it overly restricts MMs from being able to make *no change* transfers that would help reduce that risk.

By way of background, options MMs typically provide around 90% or more of displayed liquidity in the almost one million options series currently listed across sixteen registered exchanges. In the process, MM firms normally execute against incoming order flow in numerous listed series on a daily basis, which can often result in large inventories of open positions. Managing the risk of these positions can be a far more dynamic task than what is typically the case with other accounts that use options primarily for investment purposes. For example, unlike other types of accounts, MM accounts routinely absorb risk-raising positions under affirmative MM obligation, which are positions the respective MM firm often wishes to close or off-set expeditiously. Generally, the better a MM can off-set such risk, the more equipped that MM can be to facilitate new incoming public customer interest.

The risks posed by these MM positions are generally reduced through sophisticated risk management hedging strategies and management tools. One such tool is the ability to perform position transfers between *no change* MM accounts. In this respect, a broader allowance for MM *no change* transfers is a benefit to public investors, as it reduces risk for the MM firm and thereby adds to the Firm's ability to provide liquidity in options.

The use of *no change* MM transfers as a risk management tool has been diminished in recent years by way of transfer protocols that have not always been consistent among options exchanges. To the extent the *proposal* will serve as a boiler plate for other exchanges, we look forward to a standard set of rules for transfers. At the same time, however, it is important for proper risk management that the standard ultimately chosen for options broadly allows reasonable *no change* position transfers for MM firms. Unfortunately, the standard presented by the *proposal* does not.

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[3] 34-86603; SR-CBOE-2019-044

No Change transfers and Separate accounts

Under new section (a)(2), it is recognized that *no change* positions in sub-accounts of the same universal MM account that systematically match to off-set each other (i.e., "net" to close) are generally permitted transfers ("auto-transfers"). Other *no change* MM transfers may qualify for manual transferring ("selected transfers") if they do not involve accounts deemed as separate or segregated accounts under the Rule ("separate accounts"). Even if such selected transfers are between accounts not deemed to be separate accounts, however, they would nonetheless still be generally restricted from netting and still restricted from occurring in a recurring fashion – with certain exceptions (including a broad exception envisioned under the RWA proposal that will be beneficial to market participants in general). Notwithstanding the exceptions, the qualifications for meeting the transfer requirement for *no change* MM accounts are too restrictive and will unnecessarily impede options MMs from performing proper risk management of *no change* open positions in many cases.

The Exchange's view on which accounts are considered separate accounts is wide ranging. At a minimum it includes: those maintained by different "Persons": those with different aggregation units; those housed at different clearing firms; those separated by information barriers; and those required to be maintained separately pursuant to regulatory requirements. We believe the separate account delineations used to qualify transfers between *no change* MM accounts is unnecessary. In addition, the impact of applying these delineations may perhaps be worsened by a degree of ambiguity; and, indeed, the definition needs more clarity. For example, the filing states the transfer ability under (a)(2) is not intended for transactions between "different market participants" or "among accounts of different trading units".[4] It is not completely clear what is meant by these terms, but it does seem they could have multiple meanings and, therefore, should be explained more in detail. In this same vein, it is asserted in the filing that section (a)(2) will provide participants flexibility to maintain positions in accounts used for the "same trading purpose" in a manner "consistent with their businesses". As these may be seen as qualifiers to the separate accounts definition, they too can likewise be misconstrued and need more explaining.

Wash Trading

Further to the above-noted presumption of flexibility, the substantial *restrictions* on *no change* transfers will curtail flexibility more than necessary – not only because of unreasonable transfer limitations but also because of the alternatives. It should be remembered that, when considering alternatives to *no change* transferring between affiliated MM accounts, steering *no change* positions to be traded in the open market

[4] Page 6 of the filing for the *proposal* (SR-CBOE-2019-035)

raises *wash trading* concerns. The filing does not fully explain these contradictory qualities, and more clarity should be provided.

Moreover, it appears that the Exchange holds the belief that restricted *no change* MM transfers are also generally prohibited from being executed as "crosses" in the open market in light of *wash trading* and *tape painting* concerns. Thus, *no change* positions under common risk management that the Firm wishes to transfer in order to reduce overall risk can oftentimes neither cross nor transfer. This leaves MMs with choices that are often costly and inefficient. For example, carrying offsetting positions until expiration can be costly and trading them independently (rather than crossing) would often mean "paying the quoted spread", which is often a prohibitively expensive risk-strategy cost. On this point, public investors are harmed when added expenses translate into wider quotes from MMs. These are concerns of importance with respect to the *proposal* but are not currently detailed in the rule filing.

Consolidating Accounts

Under section (a)(3) of the *proposal*, relief would be available to consolidate affiliated *no change* accounts if the consolidation involves a transfer of all positions from one account to another (as opposed to simply transferring some positions to an affiliated account).

As noted above, our view is that if *no change* MM transfers are broadly permitted it will provide valuable risk reductions of ultimate benefit to public investors and market participants in general. This would include *no change* transfers that involve partial position transfers in a MM account as well as transfers of all positions in a MM account.

Separate Accounts and Common Ownership

Under the *proposal*, *no change* transfers will be heavily restricted with respect to separate universal and standard MM accounts, even if the accounts are closely risk managed together. Yet, reducing risk for firms and increasing liquidity for public investors are goals that can be achieved by transfers between separate accounts in equal fashion to accounts not separated. Generally, regardless of how such positions are carried, or how the underlying positions were executed, if *no change* MM positions are closely risk managed collectively, the ability to make risk management transfers should be available without the noted *restrictions*.

When a MM firm decides to carry *no change* positions in separate MM accounts, it should not automatically result in those positions being treated as separate for transfer purposes. Rather than separated by any regulatory requirement, these accounts are primarily carried separately by firms for accounting, operational or risk management purposes – none of which alters their *no change* status. The basic qualifier for *no change* status is the absence of a material profit or loss impact to the beneficial owners. Where there is no material difference in beneficial ownership, legal or equitable, there is no credible basis for treating them differently on a transfer related basis, especially when the transfer serves a market benefit to public investors. Nor does the Exchange articulate any basis to treat them differently in the filing.

In certain respects, the *proposal* appears to treat the separate accounts transfer question as if the answer should turn on whether the position-creating trades may have occurred while subject to potentially different order and execution requirements, such as whether the order ticket needed to be marked as long or short. To the extent any of these separate account *restrictions* are based on unsound presumptions, the restrictions would needlessly hinder proper risk management. If the Exchange believes that approving *no change* MM transfers between such separate accounts will create regulatory concerns, perhaps a better solution would be to identify the concerns and to the extent any such concern qualifies as an actionable concern, require an appropriate compliance procedure. There is every reason to believe such concerns would best be addressed through targeted compliance guidance and examinations rather than make such transfers subject to broad prohibitions at the expense of public investors.

In addition to the above, the RWA filing gives ample reasoning for believing *no change* MM transfers can and should be permitted broadly. In that filing, as part of the justification for broadly allowing transfers between *no change* accounts without the aforementioned segregation, routine-use and netting restrictions; the Exchange stated the following[5]:

> *"A market participant effecting an RWA transfer is analogous to an individual transferring funds from a checking account to a savings account, or from an account at one bank to an account at another bank – the money still belongs to the same person, who is just holding it in a different account for personal financial reasons."*

Information Barriers

It is likewise the case that broadly restricting *no change* MM transfers on the basis of Information Barriers without assessing the degree or purpose of the barriers is unreasonable. While such barriers by broker-dealers are often used to protect investors from persons inappropriately coordinating on related trade activities or illegitimately sharing information of a market sensitive nature, these are not typically issues germane to post-trade transferring between *no change* MM accounts for risk management purposes. Indeed, maintaining barrier separations between *no change* MM accounts for trading purposes has generally not been to increase the regulatory burden for such firms but, rather, to reduce it – so that traders may engage in their trading activities in a normal fashion without incurring the bias of improper transaction-related activities.

[5] 34-86603; SR-CBOE-2019-044 Pages 6 and 7

In the present case, the Exchange points to separating accounts for transaction-related activities as a reason to invoke post-trade transfer separations. Yet, transfers are neither reported to the consolidated tape nor involve open market executions. Separating *no change* MMs for such purposes should not automatically include having to separate them from using common risk management tools, such as off-floor transfers.

In light of the above, it is unreasonable to the MMs and unfair to public investors to diminish the associated benefits of information barriers by attaching unnecessary *no change* transfer restrictions to them. If the Exchange believes there is a harmful nexus between separately maintained MM accounts and information barriers that could manifest from a *no change* transfer, the Exchange should explain this concern in more detail. In cases where information barrier concerns may apply, it is far better to identify the concern and implement the protective measures in those specific cases rather than to broadly prohibit all MM transfers between such *no change* accounts

The Routine Use restriction and impacts on the Auction Market Process

The routine and recurring prohibition is broadly applied under the *proposal.* Section (g) of the Rules states that:

> *"The off-floor transfer procedure is not to be used repeatedly or routinely in circumvention of the auction market process".*

In the case of the *no change* MM exception under paragraph (a)(2), it appears it will be a frequent scenario where a *no change* MM transfer does not conflict with the netting or separate account restrictions and would otherwise qualify for a transfer if not for the routine and recurring restriction. The filing, however, gives no guidance on what would constitute routine or recurring, as used in the Rule. Also, the Exchange points out in section (d) of the Rule that pre-notification does not equate to Exchange approval and adds that "...off-floor transfers that do not conform to the requirements of this Rule will be subject to appropriate disciplinary action in accordance with the Rules". While TPHs should be given adequate guidance on what is meant by routine or recurring, the bottom line is that there should be no frequency restriction on risk-reducing *no change* MM transfers.

Additionally, the reference in section (g) to "the auction market process" is counter-intuitive. As discussed above, arranging open market *no change* transactions between affiliated MMs raises *wash trading* concerns – and *wash trading* is not generally considered "part of the auction market process". Therefore, to the extent it avoids *wash trading* possibilities, a *no change* MM transfer would not be in "circumvention" of that process, but rather, would help the firm avoid the auction market problems of *wash trading* and *tape painting.*

The real harm to investors in these cases would be to preclude such *no change* transfers and thereby instead steer the activity into the open market for trading where they might cross or match, which could then become market activity not fully envisioned as part of the "auction market process". The Exchange has presented no regulatory sound reason for imposing a repeated or routine frequency restriction for risk-reducing *no change* MM transfers, and none exists in the Rule.

No-Change Transfers and the Longstanding Policy

We appreciate that the *proposal* would bring some new opportunities for *no change* transferring to TPHs, but we are concerned that it would also undercut the Exchange's longstanding policy ("*longstanding policy*") for off-floor transfers, which we believe has historically provided broad abilities for *no change* off-floor transfers by MMs without the frequency, netting or separate account restrictions contained in the *proposal.* Adopting a rule for MM transfers in line with the *longstanding policy* would bring valuable market protections to public investors and serve the public interest. Although the Exchange does not acknowledge the same applicability of the *longstanding policy* in the filing, the matter should be addressed in more detail, particularly because the filing references Rule 6.49(a) in relation to off-floor transfer prohibitions and the exceptions noted in Rule 6.49A. It is useful in this regard to review the connection between 6.49(a) and 6.49A.

By way of background, when Rule 6.49A was originally approved in December of 1995, the Approval Order acknowledged at the very beginning of the Description section that *no change* transfers had been permitted before the Rule was proposed and inferred they would be permitted after the Rule was adopted. Specifically, it stated:[6]

> *The Exchange has a* ***long-standing policy*** *of prohibiting off-floor transfers of options positions between accounts, individuals, or entities* ***where a change of beneficial ownership would result****. The Exchange, however, previously has made* ***exceptions*** *to this general policy under certain limited circumstances, allowing* ***otherwise prohibited*** *transactions to be completed off the floor of the Exchange.* (emphasis added)

The reference to the *long-standing policy* suggests that the new Rule was focused on *exceptions* to the full on-floor requirement for trading positions where a change of beneficial ownership existed – and was not meant to alter *no change* transfers for which the on-floor requirement did not apply[7]. In a footnote to the Approval Order it was noted that 6.49(a) generally requires that Exchange options transactions be effected

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[6] Release No. 34-36647; SR-CBOE-95-36

[7] When the filing makes the additional statement that such positions were *otherwise prohibited* from off-floor transferring, it is apparently referring to matched positions where there **is** a change of beneficial ownership. The 1995 rule filing suggests how some of these *otherwise prohibited* matched positions had characteristics in common with *no-change* transfers that, in the past, merited ad hoc *exceptions* by the Exchange for off-floor transferring. Clearly, the authors and supporters of the Rule were not about to eliminate the very *no-change* scenario that provided the basis for adopting the *some-or-all change* exceptions in the first place.

on the Exchange or another listing exchange.[8] The term "transaction" is used here in distinguishable fashion from the term "transfer", which is often the case when speaking in terms of *on-floor* and *off-floor* crossing considerations.[9]

It appears that the original Rule filing avoided any attempt to alter the pre-existing *longstanding policy* that allowed *no change* position transfers to occur off-floor. This perception is bolstered by the manner in which the new Rule was structured to allow the new "exception" cases an exemption from the full open market requirement even though they involved "some" or "all" changes in beneficial ownership.[10] It was unnecessary to add a section in the Rule for *no change* transfers, as it was presumably understood that *no-change* transfers were already accepted under the *long-standing policy*, placing them beyond the scope of the Rule. Consequently, it appears that neither Rule 6.49A nor 6.49(a) originally intended to limit *no change* transfers. The Exchange should explore the reasons for the original adoption of the Rule, particularly with regard to the apparent perception at the time that broadly allowing *no change* MM transfers is better for public investors than imposing a rule to restrict such transfers.

The Restriction on Netting

The restriction on netting is significant and should be removed from the *proposal*. When an off-set in the same series carried in separate accounts affords the opportunity to "net", it has the benefit in many cases of closing both positions. This not only reduces inventory and associated costs for the MM firm, it has a downstream impact that can also allow for a better reflection of clearing firm obligations to the OCC Clearing Fund. It can also have a favorable impact on capital requirements, as contemplated by the RWA filing. The RWA filing will certainly help alleviate concerns with the netting restriction of the *proposal*, but it will not eliminate them.

There is no appropriate reason to distinguish between opening and closing option positions for transfer purposes. Indeed, the troubling outcome is when such positions co-exist at a time where the respective traders and their risk managers view such related positions in a collective "off-setting" manner, rather than individual pieces to separate strategies. In these cases, prohibiting transfers of such *no change* positions, and allowing the off-setting positions to co-exist without an economic purpose, can serve to misleadingly inflate the economic realities of overall open interest. Transferring such positions to "close" is far better from a regulatory point of view. Also, prohibiting transfers of *no change* positions on the basis of netting creates open-interest and risk management problems that can and should be avoided. The *netting* restriction could also be problematical in these regards for account types other than MMs. We believe the SEC should asses these netting concerns generally.

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[8] Footnote No. 5.

[9] Around the time of the 1995 filing of Rule 6.49A, *wash sales* and *tape painting* were regulatory concerns, as they are today, and *no change* transfers served an important related purpose by preventing such activities from occurring on the floor.

[10] The construction of the Rule, as originally written, aligns with the *longstanding policy*. Paragraph (a)(1) addresses the *some-change* exceptions in the form of off-floor transfers, while paragraph (a)(2) addresses the *all-change* exceptions in the form of on-floor Transfer Packages.

The Proposal notes consistencies with rules of other exchanges

As to the matter of other exchanges and similar rules, it would appear that the other exchanges that adopted aspects of the Rule did so, to a significant degree, on the basis of CBOE interpretations of the Rule that apparently evolved years after its adoption, which we believe were interpretations that strayed from the Rule's original intent. Currently, the rules of other options exchanges regarding *no change* transfers between affiliated MMs under common risk management vary (in some cases appreciably), but were much more in sync for many years at and after the Rule was approved at the CBOE in 1995. These rules should now be put back in sync.

Notwithstanding our concerns with the *proposal* in its current form, we are nonetheless encouraged that it provides an opportunity to begin the process of developing a standard rule for all options exchanges. We believe the *proposal* serves as a good first step in that direction, but needs material revisions, as noted, before being considered as that standard.

Conclusion

We commend the Exchange in this effort to resolve the current confusion over *no change* transfers. However, given the concerns raised in this letter, we believe applying such substantial *restrictions* to risk-reducing *no change* MM transfers is not in keeping with the requirements of the Securities Exchange Act of 1934 and accepted trade practice principles. Moreover, we note the broader availability for *no change* transfers contained in the RWA filing and believe such broader treatment should be likewise available for all *no change* MM transfers effected for risk management purposes.

As discussed in the letter, the *proposal* unreasonably delineates conditions for determining whether certain *no change* accounts are "separate". Also, the disparate treatment of restrictions applied to netting and repeated-or-routine frequency is unreasonable. In addition, applying these substantial *restrictions* to *no change* MM accounts appears arbitrary and unnecessary. Ultimately, in these regards, the *proposal* places an undue burden on competition by increasing expenses more than necessary and thereby diminishing the ability of MMs to provide more liquidity in options. The *proposal* fails to provide justification for imposing such substantial restrictions on *no change* MM transfers. Until these problems are remediated, the *proposal* lacks the required statutory bases for so broadly restricting *no change* MM transfers.

Thus, while we appreciate that the *proposal* is meant to standardize a process for certain *no change* intra-firm transfers, and notably includes new paragraph (a)(2) in this regard, our view is that a broader allowance for *no change* transfers would be of more benefit to public investors and market participants. In this regard, overly restricting *no* *change* transfers deprives public investors of market protections that normally accompany stronger and better risk management by MMs.

Although it appears the goal of the *proposal* may have been to remove impediments and perfect the mechanism of a free and open market, in certain respects it unreasonably adds impediments and inefficiencies, which is inconsistent with Section 6(b)(5) of the Act.[11] Accordingly, we believe the *proposal* is insufficient in its present form.

Sincerely

Gerald D. O'Connell
SIG – Compliance Coordinator

cc: John Roeser, SEC Division of Trading and Markets
Richard Holley, SEC Division of Trading and Markets

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[11] 15 U.S.C. 78 f (b) (5).