SUSQUEHANNA

December 12, 2019

Ms. Vanessa Countryman
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); and the related Approval/Disapproval Order (Release No. 34-87374; File No. SR-CBOE-2019-035

Dear Ms. Countryman:

Susquehanna International Group, LLP ("SIG")[1] submits this letter with further concern to matters raised in our previous letter ("our previous response"),[2] regarding the Cboe Exchange Inc. ("CBOE" or the "Exchange") Position Transfer Rule proposal referenced above (the *"proposal"*)[3] to amend Rule 6.49A, recently renumbered Rule 6.7 ("the Rule").[4]

After the Securities and Exchange Commission ("SEC" or "Commission") acknowledged in the above-captioned Approval/Disapproval Order ("A/D Order") that there are "substantive concerns raised by commenters" with respect to the *proposal* and requested additional input to help further consider the *proposal*, the CBOE submitted a response letter reaffirming its support for the *proposal* (the "CBOE response").[5] We continue to disagree with the basic premises relied upon by the CBOE for the *proposal* and believe the CBOE response did not adequately address the

[1] SIG affiliated companies have operated as registered market makers and brokers in the U.S. listed options market for over 30 years and collectively participate in a significant percentage of daily listed options volume.

[2] SIG's previous comment letter on this filing was submitted on August 19, 2019 (See letter on behalf of SIG from Gerald D. O'Connell).

[3] The *proposal* includes two CBOE letter amendments: Amendment No. 1 (letter of August 6, 2019) removed aspects relating to RWA transfers and incorporated them into a separate proposal, which has since been approved; Amendment No 2 (letter of October 7, 2019) was administrative and dealt with renumbering rules.

[4] The CBOE renumbered Rules 6.49 to 6.7 in a filing of October 16, 2019 (Release No. 87320/SR- CBOE-2019-095). For the sake of consistency, we refer to the rule numbers herein on a pre-conversion basis, as they stood at the time of the filing of the *proposal*.

[5] CBOE letter from Laura Dickman dated November 15, 2019.

substantive concerns referenced in the AD Order.[6] On the pages that follow, we assess the CBOE response against the backdrop of the issues related to the *substantive concerns* and give our reasons for the continued belief that the filing, as written, lacks a sufficient statutory basis for approval. We thank the SEC for this additional opportunity to respond.

The Substantive Concerns

In our previous response, we identified significant issues with the *proposal* and suggested meaningful revisions, as did another industry commenter.[7] Together these issues form the core of the *substantive concerns* referenced by the SEC. We provide general descriptions of related issues below:

- Lack of Justification: the CBOE has failed to provide a justification for the *proposal*, as more fully described in this letter.
- Undercutting the *Longstanding Policy*: the *proposal* is based on an erroneous current view by the CBOE that its longstanding policy (the *"longstanding policy")* intended to broadly prohibit off-floor transfers of Exchange listed options positions where there is no material change in beneficial ownership ("*no change*" transfers);
- Overly Restricting *No Change* Transfers: the *proposal* allows certain *no change* transfers but broadly restricts them (not in all cases including certain RWA transfers)[8] from routine/recurring use ("frequency restriction"), transferring to close two open positions ("netting restriction"), and between accounts of different Persons and sometimes within the same Person ("separate accounts") (collectively, "the Restrictions");
- Separate Accounts ambiguity: the *proposal* not only errs by restricting *no change* transfers on the basis of separate accounts, it is also ambiguous in its description of what constitutes separate accounts:

[6] In addition to this response and our previous response, similar concerns regarding this matter were raised in two earlier submissions on behalf of SIG sent in connection with a similar previous rule filing by the CBOE, which rule filing was subsequently withdrawn. By way of further reply to the CBOE response and this matter generally, we incorporate those two earlier responses. Specifically, we incorporate the letter sent on SIG's behalf from Richard J. McDonald to Brent J. Fields, (regarding SR-CBOE-2018-060), dated October 19, 2018 (the "McDonald Letter") and we also incorporate SIG's Petition for Review filed on October 31, 2018 (regarding Release No. 34-88437/SR-CBOE-2018-060) ("the Petition"). A copy of the McDonald Letter is enclosed herewith as Exhibit 1 and a copy of the Petition is enclosed herewith as Exhibit 2.

[7] Letter from John Kinahan, Chief Executive Officer, Group One Trading, LP, dated September 24, 2019.

[8] The CBOE filed with the SEC, in August 2019, a rule change to allow off-floor *no change* transfers that serve to reduce risk-weighted asset ("RWA") capital charges. That filing was approved by the SEC and included the ability to perform such transfers with no restriction on frequency or netting. There is, however, a restriction in this new rule on transfers between different corporate entities ("persons") regardless of an ultimate *no change* status. (Release No. 34-86603) (File No. SR-CBOE-2019-044)

- Expensive Alternatives: by overly restricting *no change* transfers, the *proposal* forces expensive alternatives – such as carrying the positions until expiration (or until an opportunity arises to "close" in the open market) or "paying the spread" by trading out of the positions separately in the open market, both of which are expenses that can generally contribute to wider quotes by impacted MMs;
- Normal Auction Market Process: the *proposal* and CBOE response fail to properly address the *wash trading* concern associated with directing *no change* positions to the open market (rather than off-floor transfer) where they may interact in conflict with "the normal auction market process";
- Inflates Open Interest: to the extent the *proposal* overly restricts *no change* transfers of positions that off-set each other and MMs carry such positions when they would otherwise have netted them for risk management purposes, the result is to needlessly inflate open interest.

The Proposal Lacks Justification and Undercuts the Longstanding Policy

The *proposal* wrongly assumes that the *longstanding policy* has both currently and historically served to purposely require that the on-floor requirement for transactions includes *no change* position moves. As explained below, the *longstanding policy* was instead designed to require transactions with a material change of beneficial ownership to be effected on the Exchange (or other listed exchange) and designed to direct *no change* transfers to the off-floor transfer process. As the requirements and restrictions on transfers in the *proposal* are predicated on the accuracy of the CBOE's assumption in this regard, the *proposal* is unjustified at a base level. Of added note, the *proposal* incorrectly assumes that options market makers ("MMs") are generally restricted from managing risk through the use of *no change* transfers. As such, the *proposal* does not meet Securities Exchange Act ("Exchange Act") Section 6(b)(5)[9] requirements to:

- be designed to prevent fraudulent and manipulative acts and practices;
- promote just and equitable principles of trade;
- foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities;

[9] 15 U.S.C. 78f(b)(5)

- remove impediments to and perfect the mechanisms of a free and open market and a national market system; and
- protect investors and the public interest.

In addition to the Section 6(b)(5) concerns, the *proposal* fails to meet the standards regarding the Rules of Practice applicable to rule filings, which concern was highlighted by the SEC in the A/D Order. The Rules of Practice require that the description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding – and any failure of an SRO to provide this information may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Exchange Act and the applicable rules and regulations.[10] As the CBOE does not satisfactorily explain the conflict with the *longstanding policy*, nor justify the *proposal* in light of the *substantive concerns*, the *proposal* is inconsistent with "applicable requirements" and the filing is not "sufficiently detailed". The CBOE response did not remediate these failures, as discussed below.

No Change Transfers, the Longstanding Policy and Rule 6.49(a)

A proper understanding of the *longstanding policy* begins with understanding the intention of Rule 6.49(a), recently renumbered as Rule 5.12(a), which states in part:

> "Except as otherwise provided by the Rule, no Trading Permit Holder acting as principal or agent may effect transactions in any class of options contract listed on the Exchange for a premium in excess of $1.00 other than on the Exchange..."

The CBOE's current view of the *longstanding policy* is that Rule 6.49(a) makes no specific mention of exceptions to the on-floor requirement, which it takes to mean that Rule 6.49(a) was designed to be a generally all-inclusive prohibition against off-floor transfers, including *no change* transfers. CBOE's current view likewise assumes that this interpretation of the *longstanding policy* has generally persisted from the beginning of listed options trading and continues today, although with certain exceptions and restrictions as modified by the adoption of Rule 6.49A in 1995[11] and then years later by Regulatory Circulars (particularly "RG 03-62")[12].

CBOE's current view is in error for several reasons. First, the acceptance of *no change* transfers as a generally accepted practice for many decades belies the

[10] Rule 700(b)(3) , Commission Rules of Practice, 17CFR 201.700(b)(3)

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

[12] On July 24, 2003, Regulatory Circular RG 03-62 introduced restrictions on netting and margin changes.

assumption that market participants interpreted Rule 6.49(a) to prohibit such off-floor transfers, which increasingly became the case during the years when MM firms expanded operations to become more involved in multiple trading of options on various exchanges. Second, at a more technical level, the term "effect transactions", as used in Rule 6.49(a), is distinguishable from the term "transfer" – and distinguishing between these terms is commonly the case when speaking in regards to *on-floor* trading and *off-floor* crossing considerations.[13] Third, in similar fashion, when Rule 6.49(a) speaks of acting as a principal or agent, such terms are generally connected to floor trading and not off-floor transfers, as off-floor transferring of *no change* positions is not typically characterized, or thought of, in the context of effecting transactions as "principal or agent". Fourth, it makes sense that *no change* transfers would be permitted because intentional *wash trading* is not. Finally, as discussed more fully later in this letter, we believe the very manner by which 6.49A was written and described in the related rule filings leaves no room for concluding anything other than that the *longstanding policy* has always generally permitted *no change* position movements to be transferred off-floor.

While the *proposal* is not justifiable, as written, our recommendation is not for the CBOE to abandon the effort to initiate a standardized transfer rule among options exchanges. Instead, we recommend the CBOE amend the *proposal* to more broadly recognize the ability for *no change* transfers in a fashion consistent with the *longstanding policy* as it was adopted. Conforming the *proposal* in our recommended way would improve risk management for many MMs and benefit public investors. It would also allow the *proposal* to be consistent with the Section 6(b)(5)[14] requirements listed above.[15]

The Longstanding Policy and the Original Filing

As noted above, the intention of the *longstanding policy* was to steer transactions involving a material change of beneficial ownership to the open market and steer *no change* transfers to the off-market transfer process. Despite its legacy interpretation, the CBOE's current view is that the true intention of the *longstanding policy* was to generally ensure all position movements occur in the open market. CBOE's current view is inconsistent with the manner by which Rule 6.49A is written and structured to address certain position moves between accounts where there is an all, or substantially all, change in beneficial ownership (*"all change"*) and where there is a lesser change in

[13] 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 in the open market.

[14] 15 U.S.C. 78f(b)(5)

[15] The CBOE response refers to Nasdaq PHLX, LLC (the "PHLX") Rule 1058(c), but this Rule was adopted in an attempt to conform to the CBOE's erroneous current view. A standardizing effort could remediate this conflict by bringing the PHLX in line with the correct legacy view of the *longstanding policy*.

ownership or management of a material nature *("some change")*. As we explained in our previous letter, when Rule 6.49A was originally approved in December of 1995 (the *"original filing"*),[16] 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 did so without any mention of any of the Restrictions set forth in the *proposal* (frequency, netting or separate accounts). Specifically, it stated:

> *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)[17]

The reference to the *long-standing policy* in the original rule filing for Rule 6.49A evidences that it was focused on *exceptions* to the open market requirement for matched positions that involved a material change of beneficial ownership but, for varied reasons, nonetheless considered appropriate for off-floor transferring or other special treatment (i.e., the "Transfer Package"). It was not meant to alter *no change* transfers, as the open market requirement did not apply to them in the first place. On its face, this belies the CBOE's current view.

The original rule filing indicated that *no change* transfers would continue to be permitted after the Rule was implemented. Indeed, nothing in the filing shows an intent to eliminate the CBOE's *long-standing policy* of steering *no-change* transfers to the off-floor process.[18] To the contrary, the Purpose section of the rule filing clarifies that the Rule adds certain exceptions to the off-floor transfer part of the *longstanding policy*, as follows:

> *"In situations in which the Transferor continues to maintain* ***some*** *ownership interest or manage the positions transferred, the Transferor generally will not be required to offer the positions on the trading floor but* ***could affect an off-floor transfer of these positions****".* (emphasis added)
>
> */ and /*
>
> *The situations in which options positions will be required to be offered on the Exchange's trading floor pursuant to the* ***special procedure*** *established by the proposed rule, or on another exchange, which trades the products, will include the transfers of options in the case of the sale or disposition of* ***all or substantially all*** *of the assets or options positions*

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

[17] The CBOE response neither addresses this explicit articulation of the *long-standing policy*, nor offers any such articulation as a basis for its current view.

[18] Release No. 34-36241; SR-CBOE-95-36

of the Transferor where the Transferor would not be included in managing or owning the transferred positions. (emphasis added)

The first statement above addresses the case of *some change* position matches while the second addresses *all change* position matches. The Rule is clearly structured to correspond with these statements, as paragraph (a)(1) of the Rule addresses the *some change* exceptions in the form of upstairs/off-floor transfers, while paragraph (a)(2) addresses the *all change* exceptions in the form of on-floor Transfer Packages. It was not necessary to include and sub-divide *no-change* transfers into the structural paradigm within the Rule because *no-change* transfers were already accepted under the *long-standing policy* for off-floor transferring – and this was made clear in the rule filing. In this regard, by specifically limiting paragraphs (a) (1) and (2) to *some change* and *all change* transfers, the Rule carefully ensured the continued understanding that off-floor *no-change* transfers are beyond the scope of the Rule's restrictions.

The reference in the *longstanding policy* to *exceptions* that were *otherwise prohibited* from off-floor transferring refers to certain matched positions where a material change of beneficial ownership (*some* or *all*) existed; but also contained characteristics in common with *no-change* transfers that merited ad hoc exceptions to the on-floor requirement[19]. From this, it can be seen the Exchange concluded that exempting certain *some-or-all change* scenarios would protect and benefit the marketplace overall in much the same way that *no-change* scenarios have done under the *long-standing policy*. It can also be seen from this that it is illogical to believe the Rule was written with the intention to eliminate or restrict the *long-standing policy* for *no-change* transfers. Clearly, the authors 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.

The CBOE's Response

The CBOE response argues that there are no rules that allow *no change* transfers to freely occur. As noted above, however, the past allowances and practices for *no change* transfers to occur off-floor arose from the general understanding in regards to the *long standing* policy.[20]

Additionally, the CBOE suggested that restricting *no change* MM transfers need not be an issue because affiliated MMs could instead simply clear all their trades in a "universal account".[21] The basic problem with this presumption is that, rather than have all affiliated MMs put all their respective trades in one universal account, it is

[19] While the *some change* portion of the Rule addresses charitable donations and gifts to minors, these are not distinguished on an ownership/management basis in the same fashion as the other exceptions to that section.

[20] The CBOE's current view, obviously, is a departure from the view and practice of CBOE regulation staff at the time of the Exchange's articulation of the long-standing policy quoted above.

[21] As noted in the McDonald Letter, the CBOE's current view wrongfully discriminates against firms with standard accounts.

beneficial to the supply of liquidity to investors that certain *no change* MMs maintain separate accounts. Though such MM trading may occur separately, there is a need to manage the MM risk collectively. The ability to help meet this need by transferring on a *no change* basis without the Restrictions is an important part of risk management for such MM firms – and this need is recognized in the *longstanding policy*. When *no change* MMs under the same risk management trade separately, it is frequently the case that post-trade risk reviews identify hedging and closing opportunities that can be realized through transfers. In such cases, sometimes a transfer would be advisable and in other cases the positions are better maintained separately to meet certain economic purposes of value to the firm's ability to meet its MM requirements. For example, after an options expiration, risk management efforts can frequently identify residual remaining MM positions maintained in separate *no change* accounts that could serve as off-sets to each other, in which case it can be efficient to transfer such positons between the respective accounts.

While we assert there are costs associated with carrying and trading positions that could otherwise be matched off-floor on a *no change* basis, the CBOE asserts that these are costs borne by all market participants, and not just MMs. The CBOE indicated in its response that MMs should not consider themselves any different to any other account class when it comes to having to carry unwanted positions or paying additional unwind costs.[22]

The CBOE's view of the balance between such risks and costs is shortsighted and shows disregard for the degree by which exchanges solicit MM support for liquidity – and the degree by which MMs respond with that support in an era of growing exchanges and products. Indeed, restricting MMs from broad *no change* transferring not only deprives MMs of a longstanding avenue to manage risk, it also undermines the structure created by options exchanges (including the CBOE) that relies heavily on MMs for the vast majority of liquidity. Historically, over 90% of displayed options liquidity emanates from MM houses. To meet this liquidity need for nearly one million listed options series offered collectively by the 16 options exchanges (the "exchanges"), options exchange rule books place extensive firm-quoting and affirmative trading obligations on MMs. Meeting these requirements ultimately results in many MMs quoting and trading more often, and in greater sizes, than they would like – which they must be ready to routinely do in most of the nearly one million series across the 16 exchanges, and often with less priority/parity and higher fees than the customers they facilitate. It is frequently the case, for example, that *no change* affiliated MMs facilitate orders in series of the same class on different exchanges within seconds of each other in separately maintained MM accounts.

---

[22] The CBOE response misses the point that exchange fees apply to actual trades, and should have no application to *no change* transfers. For such internal risk management movements, exchange fees and the cost of crossing the quote spread in the market are as prohibitive as they are inappropriate.

Thus, while meeting these growing exchange liquidity needs, affiliated MMs very often assume unwanted positions. Unfortunately, notwithstanding that such unwanted positions are often the result of meeting exchange demands on MMs for quoted liquidity, the *proposal* often punishes MMs that take on such unwanted positions by imposing penal choices when the respective MMs desire to unwind or hedge such positions between *no change* accounts for risk purposes. As noted, these choices include either "paying part or all of the spread" in the market when trading out of the positions, paying to carry the positions until expiration, or paying to carry the positions in the hope of the often unlikely event of trading out of the position against incoming orders in the future.

Even though many of these unwanted positions from customer facilitations occur in series that are often not easy to trade out of, they are often heavily correlated with, and suitable risk off-sets to, other option positions in *no change* accounts (also assumed while under affirmative MM obligations). To the extent the *longstanding policy* and exchange rules recognize the ability for off-floor transfers of such positions, they provide MMs with a valuable tool to help them deal with the growing risks of more products and exchanges, which logically translates into preparing them to provide additional liquidity to more customers. The *proposal*, however, removes this tool while leaving certain MMs with the growing burden for supplying liquidity without a commensurate ability to manage the growing risk.

CBOE's rationale for the wisdom of its current view is inapt. The CBOE response states that the Exchange believes "it will best serve the options market to expose the maximum number of positions to the auction market."[23] The auction market, however, is a forum for reflecting buy and sell interest (i.e., actual supply and demand), not positions already held under common beneficial ownership. *No change* transfers do not reflect one's intent to buy from and sell to oneself, but simply to move what one already holds on one's books and records for risk management.

Moreover, the prospects of paying exchange fees and incurring the cost of reaching across the quote spread for risk movements of positions already held under common beneficial ownership (as opposed to actual trades) are prohibitive. The result of CBOE's current view is that MMs generally hold their positions as is, which entails incurrence of carrying costs and curtails risk management, all of which inhibits investor liquidity. Also, carrying off-sets (as opposed to netting them) raises exercise risks to the firm(s), which adds an additional cost. Accordingly, rather than "increase transparency and liquidity in the options market," the opposite occurs.

Rules that inadequately address the safeguarding of normal market protections and efficiencies should of course be avoided rather than embraced. In this case, for

---

[23] CBOE response, p. 11.

example, a proposal that is predicated on the maximum "exposing of positions" but does not adequately address *wash trading* should not be embraced. Indeed, as we understand it, the CBOE's current position on prohibiting *no change* transfers does not include allowing MMs or others the alternative to cross such positions on the exchange, which the CBOE implies is a necessary prohibition in light of *wash trading* concerns. This paradoxical position is in need of further explaining by the CBOE.

Looking at the CBOE's Response from Practical and Historical Perspectives

The notion that the CBOE and other exchanges never allowed a MM firm with multiple traders to engage in *no change* transfers for risk management purposes is mistaken, and fails to appreciate the environment of early options trading. For the first twenty years or so of options trading, there were no universal accounts – but there was multiple trading. Throughout those years, it was increasingly the case that MMs from the same firm, or under common ownership, would trade in the same options class or with multiple associated give-ups.

As options exchanges and listed products grew, so it was with MM firms – especially those that sought to operate in multiple markets. This created a routine risk management need for *no change* transfers. Exchanges historically relied on MMs to manage such risk by, where advisable, transferring in accordance with the *longstanding policy* concept.

As more years passed, exchanges eventually provided certain guidance to traders and clearing firms regarding off-floor *netting*, which primarily stemmed from concerns by floor traders troubled by apparent changes in publicly disseminated open interest (from off-floor transferring) without the opportunity to trade in those instances. Thus, the origin of the *netting* concern primarily arose long after adoption of the Rule and apparently more so from floor trader opportunity complaints than regulatory concerns with *no change* transfers.

As still more years passed, leading up to 1995, firms were frequently deciding that the best path forward for their options businesses would be to combine operations and merge positions for trading purposes with others, or seek financing from others. The problem in these cases, of course, was that 6.49(a) was designed to restrict off-floor transfers where a material change of beneficial ownership occurs – and mergers of such positions were typically not *no change* transfers. This led to the adoption of Rule 6.49A and the adoption of certain exceptions for off-floor transfers between accounts where there was *some change* or *all change* in beneficial ownership. It also explains why *no change* transfers were not included in the Rule (i.e. there was no need to include them because they were already exempted in full form).

Consequently, the growth in listed options trading over the years has increased the dependence on MMs for additional liquidity, which is accompanied by an increase in the need to manage risk. The *proposal*, as written, would unnecessarily and unreasonably decrease that ability to manage risk.

Conclusion

For the reasons noted above, the *proposal* is inconsistent with Exchange Act Section 6(b)(5), and should be amended to allow for *no change* transfers without the Restrictions, as noted above, in keeping with its historic and authenticated *long standing policy*.

Sincerely,

Gerald D. O'Connell
SIG Compliance Coordinator

cc: Richard Holley, SEC Division of Trading and Markets

Exhibit 1

Letter on behalf of SIG from Richard J. McDonald, dated October 19, 2018

SIG
SUSQUEHANNA
INTERNATIONAL GROUP LLP
401 CITY AVENUE, SUITE 220, BALA CYNWYD, PA 19004-1186 610.617.2600

October 19, 2018

VIA EMAIL

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

Re: Rel. No. 34-83968 (File No. SR-CBOE-2018-060)

Dear Mr. Fields:

Susquehanna International Group LLP ("SIG") appreciates the opportunity to comment on the above-referenced Cboe Exchange, Inc. ("CBOE" or the "Exchange") rule filing (the "Proposal) to amend CBOE Rule 6.49A (the "Rule"). In pertinent part, the proposal seeks to permit off-floor transfers of positions from one account to another where there is no change in ownership, but limiting such transfers to significant, non-recurring events and disallowing the netting of option positions except for universal accounts.

For the reasons noted below, the Proposal is not consistent with Securities Exchange Act (the "Act") Section 6(b)(5), in that it is not designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market, or to protect investors and the public interest (in fact, the Proposal contravenes these goals). Additionally, as discussed below, the Proposal will impose an unnecessary and inappropriate burden on competition that is not in furtherance of the purposes of the Act.

Moreover, while the Exchange claims that the Proposal codifies "certain long-standing guidance regarding what types of off-floor transfers are permissible," it actually incorporates misconceptions about the Rule's applicability that have evolved over time, in deviation from the Rule's intent and the Exchange's original guidance. As a result, the Proposal seeks to inappropriately subsume into the Rule transfers for which there is no change of beneficial interest ("No-Change Transfers"), which are beyond the scope of the Rule. Worse, it invites the execution of wash trades that inject artificial information into the market and fictitiously increase option volatility; and compels the overstatement of option open interest upon which data investors and the public rely.

Accordingly, the Securities and Exchange Commission (the "SEC' or the "Commission") should not approve the Proposal as currently submitted. By this letter, SIG also requests that the CBOE revisit the Rule and the subject Proposal, and remediate the problems noted herein through an amended rule filing.

The Subject Provisions of the Proposal

Among other provisions, which are not at issue, the Proposal would amend CBOE Rule 6.49A to provide in pertinent part as follows:

(a) *Permissible Off-Floor Transfers.* Notwithstanding the prohibition set forth in Rule 6.49(a), existing positions in options listed on the Exchange of a Trading Permit Holder or of a Non-Trading Permit Holder that are to be transferred on, from, or to the books of a Clearing Trading Permit Holder may be transferred off the Exchange (an "off-floor transfer") if the off-floor transfer involves one or more of the following events:

*****

(2) the transfer of positions from one account to another account where no change in ownership is involved (i.e., accounts of the same Person (as defined in Rule 1.1)), provided the accounts are not in separate aggregation units or otherwise subject to information barrier or account segregation requirements;

(3) the consolidation of accounts where no change in ownership is involved;

(b) *Netting, Margins, and Haircuts.*

(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.

*****

(d) *Prior Written Notice.* A Trading Permit Holder(s) and its Clearing Trading Permit Holder(s) (to the extent that the Trading Permit Holder is not self-clearing) must submit to the Exchange, in a manner determined by the Exchange, written notice prior to effecting an off-floor transfer from or to the account(s) of a Trading Permit Holder(s), except that notification is not required for transfers to correct errors under subparagraph (a)(1) of this Rule.[1]

No-Change Transfers Should Not Execute As Trades on the Exchange

As noted above, the Proposal seeks to add a provision under the Rule that would allow off-floor transfers where there is no change in ownership, by which it means accounts of the same Person (defined under CBOE Rule 1.1 to mean "an individual, partnership (general or limited), joint stock company, corporation, limited

[1] Rel. No. 34-83968 (SR-CBOE-2018-060), Exh. 5.

liability company, trust or unincorporated organization, or any governmental entity or agency or political subdivision thereof"). This seeming expansion of permissible off-floor transfers, however, actually is a limitation of the CBOE's longstanding policy allowing off-floor No-Change Transfers between accounts, individuals, or entities. This allowance was acknowledged by the Exchange when it first proposed the Rule in 1995. In its rule filing at that time, CBOE stated:

> 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*.[2] (emphasis added)

The Exchange went on to explain that the purpose of the proposed Rule was to codify certain exceptions to the requirement under its Rule 6.49(a) that transfers involving a change of beneficial ownership, whether partial or complete changes ("Change Transfers"), should be executed on the Exchange floor. From its inception, then, the scope of the Rule was limited to Change Transfers. The instant Proposal seeks to bring No-Change Transfers within the scope of the Rule, and to restrict such no Change Transfers with respect to netting and frequency, all in contravention of the aforementioned long-standing policy.[3]

By seeking to curtail the off-floor effecting of No-Change Transfers, the Proposal promotes the execution of wash trades involving no change in beneficial ownership. As the Commission is aware, such wash trades are concerning because they inject false information about supply and demand into the market. In the case of options, they also inflate volatility, upon which information investors rely in valuing options and making trading decisions. This distortion of market data would be exacerbated by the repeat and routine frequency of such wash trades as options market makers seek to efficiently manage the risk of their positions (which is a prominent regulatory concern) in order to best provide liquidity to the public.[4]

Additionally, the netting restriction sought to be imposed on No-Change Transfers artificially inflates open interest in options, upon which data investors and the public also rely. If a beneficial owner is long an option series in one account and short the same series in another account, to the extent those positions offset, open interest figures at the Options Clearing Corporation ("OCC") are inflated on both the long and short sides. Certainly, no Exchange rule should promote such market distortions to the detriment of investors and the public.[5]

---

[2] Rel. No. 34-36647 (SR-CBOE-95-36).

[3] The reasons for, and application of, the long-standing policy will be discussed *infra*.

[4] Distinguishing between accounts for risk management transfer purposes on the basis of aggregation units or information barriers is unnecessary. Historically, the compliance reason for such segregation between account types had been primarily for traders to transact in the open market, for the benefit of the market place, in a manner where they can pursue their individual strategies without creating a regulatory bias that they are coordinating inappropriately (for example, sharing information to frontrun orders). Thus, maintaining separation between No-Change accounts for trading purposes has generally not been to increase the regulatory burden on broker-dealers but, rather, to reduce it – so that traders may engage in their trading activities in a normal fashion without incurring the bias of improper activities. In the present case, the Exchange points to such "trade separations" as a reason to invoke a "transfer separation", even though transfers are not reported to the consolidated tape or involve open market executions. It makes little sense to restrict such No-Change accounts from off-floor transfers effected on a post-trade basis for risk management purposes. Separating traders for such trading purposes should not include separating them from common risk management.

[5] Allowing market maker firms to reduce position risk through No-Change Transfers that net would not only add liquidity for investors, it would appreciably help dampen the impact of extreme and unwarranted fluctuations in Clearing Fund requirements at the OCC. It would also help alleviate the artificial impact from such wash trades on the calculation formula required for certain large clearing agents under the Risk-Weighted Assets ("RWA") structure. Additionally, rather than restrict off-floor transfers that would create margin or haircut differences, it would be better to prohibit transfers that are effected primarily for that reason. Precluding them altogether is

The Proposal's attempted restrictions on No-Change Transfers are all the more dubious in that the Proposal limits such transfers to an intra-firm basis. The Proposal's limitation of such transfers to those where there is no change in ownership entails that there must be no change in legal ownership as well as beneficial ownership. It is wholly unreasonable that the Exchange would seek to drive the internal transfer of positions within a single entity to the Exchange floor to be executed as trades, when such movement of legally and beneficially owned positions is simply from a single person's "left pocket to their right pocket". Likewise, as noted, it is wholly inappropriate and detrimental to the market that market participants should be forced to execute these internal position movements in the open market where they may be viewed as wash trades.

Moreover, the legal ownership limitation sought by the Proposal contravenes the aforementioned long-standing Exchange policy allowing for the off-floor effecting of No-Change Transfers. The policy is not restricted by legal ownership, as its guiding criteria was beneficial ownership, which may extend across affiliated entities under common beneficial ownership.

This is highlighted in SEC Rule 13d-3 (Determination of Beneficial Owner), which defines a beneficial owner of securities as "any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares: (1) voting power which includes the power to vote, or to direct the voting of, such security; and/or, (2) investment power which includes the power to dispose, or to direct the disposition, of such security."[6] Section (c) of Rule 13d-3 provides, "All securities of the same class beneficially owned by a person, regardless of the form which such beneficial ownership takes, shall be aggregated in calculating the number of shares beneficially owned by such person."[7] For this reason, the positions of affiliated entities under common beneficial ownership are rightly acknowledged as aggregate positions without regard to legal ownership. The legal ownership restriction precluding off-floor No-Change Transfers among affiliated entities contravenes the SEC definition, which definition is consistent with CBOE's aforementioned long-standing policy.

The Proposal Arbitrarily Discriminates Between Broker-Dealers With Universal Accounts and Those With Standard Accounts

As noted, the Proposal generally prohibits the netting of option positions for off-floor transfers. It allows netting, however, 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."[8]

The rule filing does not articulate why universal accounts in the noted circumstances are singled out as being permitted to net offsetting option transactions, nor why standard, non-universal accounts are not so permitted. While there is no credible case for requiring any firm(s) to needlessly maintain offsetting option positions in the same series that are economically flat, artificially inflate open interest, stymie efficient risk management, and result in unnecessary carrying costs, the Proposal's selective application of this requirement is patently discriminatory.

---

overly restrictive, particularly for transfers where the public value to the market far exceeds any perceived advantage from a margin or haircut differential.

[6] 17 CFR 240.13d-3(a).

[7] 17 CFR 240.13d-3(c).

[8] Rel. No. 34-83968 (SR-CBOE-2018-060), Exh. 5.

The form of position accounting employed by a broker-dealer, whether standard or universal, makes no difference in terms of beneficial or legal ownership. The form-over-substance distinction imposed by the Proposal results in unequal treatment among broker-dealers who are similarly situated in all material respects. As noted, the arbitrarily selective netting restriction impinges the ability of standard account market makers to efficiently manage position risk, and incurs unnecessary carrying costs, while firms with universal accounts are free of these burdens. These selective burdens consequently impinge on the ability of standard account market makers to compete to provide liquidity.

Similarly, the Exchange rule filing notes that "repeated or routine off-floor transfers between entities or accounts – even if there is no change in beneficial ownership as a result of the transfer – is inconsistent with the purposes for which Rule 6.49A was adopted."[9] As universal account firms need not concern themselves with this restriction because all of their transactions clear into one account, this restriction effectively applies only to standard account firms. The inability of a standard account firm to repeatedly and routinely effect No-Change Transfers for risk management places such firms at a severe disadvantage to universal account firms, again for no good reason. It impedes effective market maker risk management for such firms, which ultimately leads to less liquidity in the form of wider quotes. Like the selective application of its netting restriction, the disparate treatment resulting from the "repeated or routine" restriction is discriminatory.

The result of these restrictions is diminished liquidity. The result of the disparate application of these restrictions is an undue burden on competition.

The Proposal Does Not Codify Long-Standing Guidance Regarding What Types of Off-Floor Transfers Are Permissible

In its rule filing, CBOE stated, "The Exchange believes the proposed rule change benefits investors, as it adds transparency to the Rules by codifying certain long-standing guidance regarding what types of off-floor transfers are permissible."[10] As noted above, however, the Proposal actually contravenes the Exchange's long-standing policy of permitting off-floor No-Change Transfers without the restrictions the Proposal currently seeks to implement. Indeed, as noted, such No-Change Transfers have been beyond the scope of the Rule since its inception.

Instead, the Proposal seeks to incorporate current misconceptions regarding off-floor transfers (the "Current Guidance") that turn on its head the origin, purpose, and scope of the Rule as well as the aforementioned long-standing policy and the Exchange guidance that had long been in place both before and after the adoption of the Rule (the "Legacy Guidance"). As described below, the misconceptions upon which the Current Guidance is based evolved over time.

Mergers and acquisitions in the options trading community were commonplace in 1995. The Rule was proposed at that time to deal with the many situations where an owner of a large "bulk" position was undergoing a change in business and wished to either dispose of the positions to an arranged buyer at an aggregate price (thereby avoiding expensive and fragmented sales of a market disrupting nature) or bring in a

[9] Rel. No. 34-83968 (SR-CBOE-2018-060), p. 13. The Exchange does not articulate what those purposes are, nor explain how repeated and routine No-Change Transfers would be inconsistent with those purposes. The rule filing notes that the "on-floor" procedure (that the Proposal discontinues) was intended to help Trading Permit Holders ("TPHs") with a need to transfer positions in bulk as part of a sale or disposition of all or substantially all of a TPH's assets or options positions; and could be used by market makers for reasons other than a forced liquidation, such as an extended vacation. The Exchange makes no mention of the intent or purpose for the rule with respect to off-floor transfers, but merely lists what the exceptions in the Rule are currently. Each of the listed exceptions involve a change in beneficial ownership. None of this relates to No-Change Transfers. Accordingly, CBOE has presented no reason for imposing a "repeated or routine" frequency restriction on No-Change Transfers, and none exists in the Rule.

[10] Rel. No. 34-83968 (SR-CBOE-2018-060), p. 13.

new financial backer or partner. In either case, the bulk transfer would involve a complete or partial "change in beneficial ownership". At that time, the only permissible off-floor transfers were No-Change Transfers, for which there were no restrictions regarding purpose, circumstances, frequency or netting (which made sense, of course, because such transfers merely involve the moving of owned positions from one's own "left pocket to their right pocket").

Accordingly, the Rule was adopted to create exceptions to the requirement that Change Transfers must execute as trades on the Exchange. Having acknowledged in its rule filing the Exchange's long-standing policy, under which No-Change Transfers were not required to execute on the floor as trades, the rule filing and the Rule itself were thereafter silent on the long-standing policy and did nothing to discontinue or restrict it. Indeed, the rule filing went on to highlight that the scope of the Rule regarded Change Transfers with full or partial beneficial ownership changes, explaining, "In situations in which the Transferor continues to maintain *some ownership interest* or manage the positions transferred, the Transferor generally will not be required to offer the positions on the trading floor but could affect an off-floor transfer of these positions"; and, "The situations in which options positions will be required to be offered on the Exchange's trading floor pursuant to the special procedure established by the proposed rule, or on another exchange, which trades the products, will include the transfers of options in the case of the sale or disposition of *all or substantially all of the assets or options positions* of the Transferor where the Transferor would not be included in managing or owning the transferred positions."[11] (emphasis added)

The structure of the Rule reflects this scope and treatment of full and partial beneficial ownership changes. Section (a)(1) of the Rule addresses partial Change Transfers in the form of off-floor transfers; and section (a)(2) addresses full Change Transfers in the form of on-floor Transfer Packages (i.e., the "special procedure" referenced above). Both measures demonstrate how the Exchange strove to accommodate special Change Transfer situations where market participants and the public would otherwise be harmed (via market disruptions and trade activity not reflective of true supply and demand interest) if such activities were steered to the open market.

The common understanding among members and exchange regulators for decades before and after the Rule was proposed was that No-Change Transfers would continue to be allowed off-floor. The CBOE, along with the other options exchanges) permitted members to effect No-Change Transfers off-floor for operational efficiency and risk management purposes; and, even more so than today, such transfers occurred each day routinely by vast numbers of market maker firms, and were accepted by the clearing firms and options exchanges. We know this from our experience as exchange members and participants in the options community during this long period; as well as the experience of several of our compliance staff who were options exchange regulators at that time, including the Philadelphia Stock Exchange ("Phlx") Market Regulation Director and Phlx representative to the Intermarket Surveillance Group.

Indeed, if the CBOE had manifested an intent in adopting the Rule to preclude such common off-floor transfers, there would have been strenuous objections from the options community to the SEC that (1) such position was neither included within nor reasonably implied by the Rule (and so should have been filed for public comment and SEC review), and (2) it would invite the self-same concerns about wash trading and open interest inflation that we raise herein. The absence of any such uproar is telling.

In 2003, the CBOE issued Regulatory Circular RG 03-62 (the "Circular"). The Circular was meant to explain and clarify certain aspects of the Rule, but was unfortunately vague on several points. In partial support of its Current Guidance (discussed below), the Exchange points to the Circular with respect to the Exchange's claimed restriction of off-floor netting and favorable margin changes. As indicated above, these concepts are neither included within nor reasonably implied by the Rule, and should have been (but were not) approached in the form of a rule filing allowing for public comment.

---

[11] Rel. No. 34-36647 (SR-CBOE-95-36).

The Circular introduced the topic of No-Change Transfers broadly under the title "Transfers that result in no change of beneficial ownership". In that section, the Circular spoke of such transfers for reorganization purposes. As confirmed by the designated contact persons within the Circular, this was meant as a mere example of permissible No-Change Transfers, and not as a delimitation of the same. The purpose for raising this example was that, at the time, the Exchange regulatory staff was receiving many inquiries about such transfers for reorganization purposes. Moreover, the question by Exchange members was generally not so much whether reorganization transfers were acceptable under the Rule (it was generally understood that they were), but rather whether they should be effected as an off-floor transfer or on-floor Transfer Package under the special procedure.

Now, many years later, the Exchange has misconstrued the scope, purpose, and applicability of the Rule; as well as the permissibility of off-floor No-Change Transfers. These misconceptions form the Exchange's Current Guidance, which has been communicated to SIG in multiple conversations.

Pointing out that, while the Rule has different sections dealing with partial and full Change Transfers, but no section on No-Change Transfers, the Exchange's Current Guidance concludes that No-Change Transfers are not permitted under the Rule. Of course, as explained above, the Rule's silence on No-Change Transfers is because they are beyond the scope of the Rule. This Current Guidance's conclusion is simply wrong.

Implicit in the Current Guidance is the notion that the aforementioned long-standing policy ceased with the adoption of the Rule, but, the history shows that the Exchange acknowledged the long-standing policy and was thereafter silent about it in its adoption of the Rule, taking no steps to discontinue or restrict the policy. The prospect that the long-standing policy would no longer exist after the Rule was adopted is likewise beyond reason because the concern with wash sales remained and the need for off-floor risk management was growing as members across exchanges were adjusting to multiple-listing of options. Indeed, it would be nonsensical to assert that transfers involving partial or complete changes in beneficial ownership are excepted from the Exchange's floor trading requirements, but transfers involving no change in beneficial ownership must be traded on the floor.

In further support of the Current Guidance, the Exchange relies on the Circular's mention of reorganizational transfers with no change in beneficial ownership, as expressing a limited and conditional allowance of off-floor No-Change Transfers. As explained above, however, this was meant as a mere example and not a limitation, and the Exchange would have had to submit the Circular for SEC approval for the Exchange's current interpretation to have any effect in any event, as it was neither included within nor reasonably implied by the Rule.[12]

The Current Guidance is particularly curious with respect to intra-firm No-Change Transfers. The Exchange's articulated position is that transfers from one account to another of positions that are wholly owned by the same firm constitute changes of beneficial ownership by virtue of the fact that they are moving from one account to another. This internal accounting factor, of course, has no bearing on the equitable interest of such firm that is the hallmark of beneficial ownership, nor with the SEC Rule 13d-3 definition of beneficial ownership noted above.

---

[12] The Current Guidance also seeks to justify its selective treatment of universal accounts by pointing to the Circular's reference to "central accounts". Current Exchange Staff claim that the reference to central accounts means universal accounts, but this is a false presumption. Universal accounts were not in wide usage in 2003; but off-floor transfers involving standard accounts were, as noted, widely prevalent across exchanges. Again, a limiting interpretation that blanket transfers regarded only universal accounts would have resulted in vigorous objections to the SEC that such limitation had no authority as it was not appropriately submitted to the SEC for public comment and Commission review. The Current Guidance's claimed restrictions of off-floor netting and margin changes also inappropriately rely on the Circular, and, if it had been noted in 2003 when the Circular was published, would likewise have been subject to the same wide protest. These currently claimed restrictions were-simply not part of the Legacy Guidance.

More curious still, the Current Guidance is that a firm may not effect such transfers off-floor because, as noted, they are deemed to be a change in beneficial ownership, but also may not be crossed on the Exchange trading floor because they would be a wash trade since there would be *no* change in beneficial ownership. While the paradox in this Guidance is evident, the Current Guidance goes on to provide that a firm may instead trade such positions independently in the trading crowds, such that, for example, the firm may sell from one account the subject positions in their respective trading crowds in the morning, and then buy them back again in the afternoon on the same day for another account within the same firm. This curious advice would result in the same wash trade concerns about false information in the market as noted above, but in an even more egregious way by adding disruption to the market (including quotes that move away from the artificial supply and demand depicted by such purchase and sale attempts) – on a repeated and routine basis no less[13] – all to effect an internal movement of fully owned positions from one account to another.[14]

In discussing the Current Guidance with the Exchange, the CBOE observed that transferring listed stock positions is unlike transferring listed option positions, because stocks have an over-the-counter market, but listed options must trade on an exchange. This prospect, however, has no nexus with the reality that No-Change Transfers are simply not trades in the traditional sense, and accordingly need not be executed on an exchange; nor that No-Change Transfers are beyond the scope of CBOE Rules 6.49(a) and 6.49A. Moreover, it does not address the harm visited by the false information that the Exchange would have injected into the market by selling its positions and then simply turn around and buy them back, for purposes of effecting a mere internal position movement, and doing so with regularity.

Conclusion

Contrary to the Exchange's blanket claims, the proposed rule change is not consistent with Section 6(b)(5) of the Act. As noted above, the result driven by the Exchange's proposed restrictions on No-Change Transfers - that they be executed as trades on the Exchange floor injects false information about supply and demand into the market. The prohibition against netting for No-Change Transfers likewise injects false information into the market about inflated open interest where a common beneficial owner(s) is both long and short the same option series. These results are inevitable, and a rule that effects them accordingly is not designed to "prevent fraudulent and manipulative acts and practices", to "promote just and equitable principles of trade", to "remove impediments to and perfect the mechanism of a free and open market", nor to "protect investors and the public interest".

Likewise, disparate treatment of netting and repeated or routine frequency under the Proposal between firms with universal accounts and those with standard accounts is arbitrary. Either system may be in place for firms with No-Change positions, and neither effects beneficial or legal ownership in any way. Indeed, the rule filing articulates no reason to treat such firms differently. Accordingly, the rule change is designed to permit unfair discrimination between broker-dealers, and places an undue burden on competition, as standard account firms may not manage risk as flexibly as universal account firms under the Proposal, which mitigates their ability to compete to provide liquidity. Until these problems are remediated, CBOE lacks the required statutory bases for its rule change.

---

13 In view of the repeat and routine frequency of off-floor No-Change Transfers under the Exchange's Legacy Guidance, it would not make sense to issue prior written notice to the Exchange, as contemplated by the Proposal. It would be unduly burdensome and of little regulatory value as an ongoing report. Rather, members would have records of such No-Change Transfers that the Exchange may request as needed, which would likely be seldom. Moreover, like the other provisions discussed above, this notice provision seeks to wrongfully incorporate into the Rule No-Change Transfers that are beyond its scope.

14 This Guidance, entailing purchases and sales that reach across the moving quote spreads both ways, would be a cost prohibitive non-starter for risk management in any event.

Given the above, we believe that the Commission should not approve the Proposal in its current form. We invite the Exchange, however, to provide explanations of the observations discussed above, and to submit a new proposal that addresses the concerns raised in this letter. Ultimately, a standard off-floor No-Change Transfer rule for the options industry would be beneficial to all market participants, including public investors.

Respectfully,

Richard J. McDonald
Regulatory Affairs

<u>Exhibit 2</u>

Petition for Review of Approved Proposed Rule Change to Amend

Exchange Rule 6.49A, dated October 30, 2018

MURPHY & McGONIGLE
A Professional Corporation

RECEIVED
OCT 31 2018
OFFICE OF THE SECRETARY

E-mail: jlombard@mmlawus.com
Direct phone: 202.661.7028
Facsimile: 202.661.7059

1001 G St., N.W.
7th Floor
Washington, D.C. 20001

October 30, 2018

SEC
Mail Processing
Section
OCT 30 2018
Washington DC
415

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

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 [redacted].

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: Susquehanna International Group, LLP	File No. SR-CBOE-2018-060

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

TABLE OF CONTENTS

TABLE OF AUTHORITIES

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/pdfframed?content=/publish/RegCir/RG03-062.pdf&section=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.

Dated: October 30, 2018

Respectfully submitted on behalf of
Susquehanna International Group, LLP,

MURPHY & McGONIGLE, P.C.

Joseph C. Lombard
Howard L. Kramer
Eric A. Bensky
James P. Dombach
1001 G Street, N.W.
7th Floor
Washington, DC 20001
Telephone: (202) 661-7028
Facsimile: (202) 661-7059
Joseph.Lombard@mmlawus.com
Howard.Kramer@mmlawus.com
Eric.Bensky@mmlawus.com
James.Dombach@mmlawus.com