

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-87374; File No. SR-CBOE-2019-035)

October 21, 2019

Self-Regulatory Organizations; Cboe Exchange, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change, as Modified by Amendment Nos. 1 and 2, Regarding Off-Floor Position Transfers

I. Introduction

On July 3, 2019, Cboe Exchange, Inc. (the “Exchange” or “Cboe Options”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend its rule relating to off-floor position transfers. The proposed rule change was published for comment in the Federal Register on July 23, 2019.<sup>3</sup> On August 6, 2019, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>4</sup> On September 4, 2019, the Commission extended the time period within which to either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change, to October 21, 2019.<sup>5</sup> On October 7, 2019, the Exchange filed Amendment No. 2 to

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 86400 (July 17, 2019), 84 FR 35438 (“Notice”).

<sup>4</sup> In Amendment No. 1, the Exchange deleted from the proposed rule change the proposal to permit off-floor risk-weighted asset (“RWA”) transfers. The exchange subsequently refiled the RWA transfer proposal as a separate proposed rule change filing in SR-CBOE-2019-044. See Securities Exchange Release No. 87107 (September 25, 2019), 84 FR 52149 (October 1, 2019) (order approving proposed rule change to adopt Cboe Rule 6.49B regarding off-floor RWA transfers). When the Exchange filed Amendment No. 1 to CBOE-2019-035, it also submitted the text of the amendment as a comment letter to the filing, which the Commission made publicly available at <https://www.sec.gov/comments/sr-cboe-2019-035/srcboe2019035-5917170-189047.pdf>.

<sup>5</sup> See Securities Exchange Act Release No. 86861 (September 4, 2019), 84 FR 47627 (September 10, 2019).

the proposed rule change.<sup>6</sup> The Commission received two comment letters on the proposal.<sup>7</sup> This order institutes proceedings under Section 19(b)(2)(B) of the Act<sup>8</sup> to determine whether to approve or disapprove the proposed rule change.

## II. Description of Proposed Rule Change, as Modified by Amendment Nos. 1 and 2

Cboe generally requires a Trading Permit Holder (“TPH”) to effect transactions in listed options on an exchange.<sup>9</sup> Notwithstanding that provision, Cboe permits certain types of transfers involving a TPH’s positions to be effected off the Exchange (also referred to as “off-floor” transfers).<sup>10</sup> The Exchange now proposes to delineate in the rule additional types of permitted off-floor transfers.

Specifically, the proposed rule change would specify several additional types of permitted off-floor transfers, including (1) transfers to correct a bona fide error in the recording of a transaction or the transferring of a position to another account, (2) transfers between accounts where

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<sup>6</sup> In Amendment No. 2, the Exchange updated cross-references to Cboe rules throughout the proposed rule change to reflect separate amendments it made to its rulebook in connection with the Exchange’s technology migration, which it subsequently completed on October 7, 2019. When the Exchange filed Amendment No. 2 to CBOE-2019-035, it also submitted the text of the amendment as a comment letter to the filing, which the Commission made publicly available at <https://www.sec.gov/comments/sr-cboe-2019-035/srcboe2019035-6258833-192955.pdf>. The Commission notes that in addition to the cross-references updated in Amendment No. 2, the Exchange relocated Rule 6.49A to Rule 6.7 in its post-migration rulebook and made conforming changes to its proposed rule change to reflect that new rule number.

<sup>7</sup> See Letter to Vanessa Countryman, Secretary, Commission, dated September 24, 2019, from John Kinahan, Chief Executive Officer, Group One Trading, L.P., available at <https://www.sec.gov/comments/sr-cboe-2019-035/srcboe2019035-6193332-192497.pdf> (“Group One Letter”) and Letter to Brent J. Fields, Secretary, Commission, dated August 19, 2019, from Gerald D. O’Connell, Compliance Coordinator, Susquehanna International Group, LLP, available at <https://www.sec.gov/comments/sr-cboe-2019-035/srcboe2019035-5985436-190350.pdf> (“SIG Letter”).

<sup>8</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>9</sup> See Cboe Rule 5.12(a) (formerly Rule 6.49(a)).

<sup>10</sup> See Cboe Rule 6.7(a) (formerly Rule 6.49A(a)).

there is no change in ownership provided the accounts are not in separate aggregation units or otherwise subject to information barrier or account segregation requirements, (3) consolidation of accounts where no change in ownership is involved, and (4) transfers through operation of law from death, bankruptcy, or otherwise.<sup>11</sup>

Proposed paragraph (b) purports to codify Exchange guidance regarding certain restrictions on permissible off-floor transfers related to netting of open positions and to margin and haircut treatment, including a prohibition against netting and transfers that result in preferential margin or haircut treatment.<sup>12</sup> Proposed paragraph (c) would provide guidance as to the permitted transfer price at which an off-floor transfer may be effected.<sup>13</sup>

Proposed paragraph (d) would specify when written notice would be required prior to effecting an off-floor transfer.<sup>14</sup> Similarly, proposed paragraph (e) would provide certain recordkeeping and information requirements.<sup>15</sup>

### III. Summary of the Comments

To date, the Commission has received two comment letters on the proposal.<sup>16</sup> One commenter criticized the proposal as “overly restrictive” in how it applies “to transfers involving no material change of beneficial ownership,” which it referred to as “‘no change’ transfers.”<sup>17</sup> The commenter expressed particular concern to the extent the proposal would restrict “transfers

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<sup>11</sup> See proposed Cboe Rule 6.7(a).

<sup>12</sup> See proposed Cboe Rule 6.7(b). See also Cboe Options Regulatory Circular RG03-62 (July 24, 2003).

<sup>13</sup> See proposed Cboe Rule 6.7(c).

<sup>14</sup> See proposed Cboe Rule 6.7(d).

<sup>15</sup> See proposed Cboe Rule 6.7(e).

<sup>16</sup> See supra note 7.

<sup>17</sup> See SIG Letter, supra note 7, at 1.

between no change [market maker] accounts using broadly defined separate account delineations, and coupling that with strict prohibitions on routine-use and netting,” which the commenter argued would “unnecessarily and unreasonably restrict the ability of affiliated options market makers . . . to perform risk-reducing no change transfers.”<sup>18</sup> The commenter also believed that the proposal would “undercut the Exchange’s longstanding policy,” which the commenter characterized as having “historically provided broad abilities for no change off-floor transfers by [market makers] without the frequency, netting or separate account restrictions contained in the proposal.”<sup>19</sup> Similarly, the commenter believed that the impact of the proposed “separate account delineations” concept could “perhaps be worsened by a degree of ambiguity” and accordingly “needs more clarity” in the proposal.<sup>20</sup> The commenter argued that there exists certain impracticalities or impediments to accomplish no change transfers through exchange trading, and therefore market makers are presented with “choices that are often costly and inefficient” and that may ultimately harm investors if “added expenses translate into wider quotes . . . .”<sup>21</sup> The commenter further expressed concern that “prohibiting transfers of such no change positions, and allowing the off-setting positions to co-exist without an economic purpose, can serve to misleadingly inflate the economic realities of overall open interest.”<sup>22</sup> Finally, the commenter argued that the proposal “fails to provide justification for imposing” what it

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<sup>18</sup> See id.

<sup>19</sup> See id. at 7.

<sup>20</sup> See id. at 3.

<sup>21</sup> See id. at 4.

<sup>22</sup> See id. at 8.

considers to be “substantial restrictions” on transfers involving no material change in beneficial ownership, and it “lacks the required statutory bases for so broadly restricting” such transfers.<sup>23</sup>

Another commenter expressed similar concerns, in particular that the proposal “does not permit the use of the off-floor transfer procedure repeatedly or routinely in circumvention of the normal auction market process.”<sup>24</sup> The commenter argued that “a no change transfer is inherently different than a trade that occurs in the normal auction market process, and further noted that it is “unaware of any normal auction market process that would allow for a single market participant to transact with itself in order to move a position across two accounts maintained by that same market participant.”<sup>25</sup> Rather, commenter noted that “[i]n a no change transfer, there is no buyer and there is no seller. These positions are already owned by the market participant after being acquired through the normal auction market process.”<sup>26</sup> The commenter believed that “[m]ore clarity needs to be provided to the breadth of the current language prohibiting the ‘non-routine, non-recurring’ use of no change transfers.”<sup>27</sup>

#### IV. Proceedings to Determine Whether to Disapprove SR-CBOE-2019-035 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act to determine whether the proposed rule change, as modified by Amendment Nos. 1 and 2, should be approved or disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change, as discussed below, and the comments on the proposal. Institution of proceedings does not indicate that the Commission has

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<sup>23</sup> See id. at 9.

<sup>24</sup> See Group One Letter, supra note 7, at 1.

<sup>25</sup> See id.

<sup>26</sup> See id. at 2.

<sup>27</sup> See id.

reached any conclusions with respect to any of the issues involved.

Pursuant to Section 19(b)(2)(B) of the Act, the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis and input concerning the proposed rule change's consistency with the Act, in particular with Section 6(b)(5) of the Act,<sup>28</sup> which requires, among other things, that the rules of a national securities exchange be 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 and a national market system and, in general, to protect investors and the public interest.

The Commission believes that proceedings are appropriate to solicit additional input from the public, as well as the Exchange, to consider further the substantive concerns with the proposal that were raised by the commenters, including the applicability of the proposal to transfers involving no material change in beneficial ownership, its impact in particular on market makers and liquidity, and the scope and applicability of the proposed restrictions on non-routine, non-recurring movements of positions "in circumvention of the normal auction market process" as well as the proposed prohibition on netting.

Under the Commission's Rules of Practice, the "burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder . . . is on the self-regulatory organization ['SRO'] that proposed the rule change."<sup>29</sup> 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

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<sup>28</sup> 15 U.S.C. 78f(b)(5).

<sup>29</sup> Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3).

support an affirmative Commission finding,<sup>30</sup> 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.<sup>31</sup>

For the reasons discussed above, the Commission believes it is appropriate to institute proceedings pursuant to Section 19(b)(2)(B) of the Act to determine whether the proposal should be approved or disapproved.

V. Procedures: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data and arguments with respect to the concerns identified above, as well as any other concerns they may have with the proposed rule change. In particular, the Commission invites the written views of interested persons concerning whether the proposal, as modified by Amendment Nos. 1 and 2, is inconsistent with Sections 6(b)(5)<sup>32</sup> and 6(b)(8)<sup>33</sup> or any other provision of the Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval which would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4 under the Act,<sup>34</sup> any request for an opportunity to make an oral presentation.<sup>35</sup>

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<sup>30</sup> See id.

<sup>31</sup> See id.

<sup>32</sup> 15 U.S.C. 78f(b)(5).

<sup>33</sup> 15 U.S.C. 78f(b)(8).

<sup>34</sup> 17 CFR 240.19b-4.

<sup>35</sup> Section 19(b)(2) of the Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants to the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See

Interested persons are invited to submit written data, views, and arguments regarding whether the proposal, as modified by Amendment Nos. 1 and 2, should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register]. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2019-035 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-CBOE-2019-035. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F

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Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).



Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change.

Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to

make available publicly. All submissions should refer to File Number SR-CBOE-2019-035 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>36</sup>

Eduardo A. Aleman  
Deputy Secretary

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<sup>36</sup> 17 CFR 200.30-3(a)(12).