SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-89707; File No. SR-CBOE-2020-074)

August 28, 2020

Self-Regulatory Organizations; Cboe Exchange, Inc.; Notice of Filing of a Proposed Rule Change Relating to Adopt Compression Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on August 19, 2020, Cboe Exchange, Inc. (the "Exchange" or "Cboe Options") filed with the Securities and Exchange Commission (the "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

Cboe Exchange, Inc. (the "Exchange" or "Cboe Options") proposes to adopt Compression orders. The text of the proposed rule change is provided in Exhibit 5.

The text of the proposed rule change is also available on the Exchange's website (http://www.cboe.com/AboutCBOE/CBOELegalRegulatoryHome.aspx), at the Exchange's Office of the Secretary, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in

1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to adopt Compression or Position Compression Cross ("PCC") orders. Currently, the Exchange facilitates compression forums on the trading floor at the end of each calendar week, month, and quarter in which Trading Permit Holders ("TPHs") may reduce open positions in series of S&P 500 Index ("SPX") options in order to mitigate the effects of capital constraints on market participants. SEC Rule 15c3-1 (Net Capital Requirements for Brokers or Dealers) ("Net Capital Rules") requires that every registered broker-dealer maintain certain specified minimum levels of capital.[3] The Net Capital Rules are designed to protect securities customers, counterparties, and creditors by requiring that broker-dealers have sufficient liquid resources on hand, at all times, to meet their financial obligations. Notably, hedged positions, including offsetting futures and options contract positions, result in certain net capital requirement reductions under the Net Capital Rules.[4]

All Options Clearing Corporation ("OCC") clearing members are subject to the Net Capital Rules. However, a subset of clearing members are subsidiaries of U.S. bank holding companies, which, due to their affiliations with their parent U.S. bank holding companies, must comply with additional bank regulatory capital requirements pursuant to rulemaking required

3 17 CFR §240.15c3-1.

4 In addition, the Net Capital Rules permit various offsets under which a percentage of an option position's gain at any one valuation point is allowed to offset another position's loss at the same valuation point (e.g. vertical spreads).

under the Dodd-Frank Wall Street Reform and Consumer Protection Act.[5] Pursuant to this mandate, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation approved a comprehensive regulatory capital framework for subsidiaries of U.S. bank holding company clearing firms.[6] Generally, these rules imposed higher minimum capital requirements, more restrictive capital eligibility standards, and higher asset risk weights than were previously mandated for clearing members that are subsidiaries of U.S. bank holding companies under the Net Capital Rules. Furthermore, these rules do not permit deductions for hedged securities or offsetting options positions.[7] Rather, capital charges under these standards are based on the aggregate notional value of short positions regardless of offsets. As a result, Clearing Trading Permit Holders ("CTPHs") generally must hold substantially more bank regulatory capital than would otherwise be required under the Net Capital Rules.[8] The impact of these regulatory capital rules is

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5 H.R. 4173 (amending section 3(a) of the Securities Exchange Act of 1934 (the "Act") (15 U.S.C. § 78c(a))).

6 12 CFR §50; 79 FR 61440 (Liquidity Coverage Ratio: Liquidity Risk Measurement Standards).

7 Many options strategies, including relatively simple strategies often used by retail customers and more sophisticated strategies used by market-makers and institutions, are risk-limited strategies or options spread strategies that employ offsets or hedges to achieve certain investment outcomes. Such strategies typically involve the purchase and sale of multiple options (and may be coupled with purchases or sales of the underlying assets), executed simultaneously as part of the same strategy. In many cases, the potential market exposure of these strategies is limited and defined. Whereas regulatory capital requirements have historically reflected the risk-limited nature of carrying offsetting positions, these positions may now be subject to large regulatory capital requirements. Various factors, including administration costs; transaction fees; and limited market demand or counterparty interest, however, discourage market participants from closing these positions even though many market participants likely would prefer to close the positions rather than carry them to expiration.

8 See Letter from Cboe, New York Stock Exchange, and Nasdaq, Inc., to the Honorable Randal Quarles, Vice Chair for Supervision of the Board of Governors of the Federal Reserve System, March 18, 2020.

compounded in the SPX options market due to the large notional value of SPX contracts and the significant number of open SPX positions.

The Exchange believes these regulatory capital requirements have impeded efficient use of capital and undermine the critical liquidity role that Market-Makers play in the SPX options market by limiting the amount of capital CTPHs can allocate to clearing member transactions. Specifically, the Exchange understands these rules have caused, and may continue to cause, CTPHs to impose stricter position limits on their clearing members. These stricter position limits may impact the liquidity Market-Makers might supply in the SPX market,[9] which impact may be heightened when markets are volatile, and this impact may be compounded when a CTPH has multiple Market-Maker client accounts, each having largely risk-neutral portfolio holdings.[10] The Exchange believes that permitting TPHs to close open interest in offsetting SPX options positions in open outcry compression forums has had a beneficial effect on the bank regulatory capital requirements of CTPHs' parent companies without adversely affecting the quality of the SPX options market.

In November 2019, bank regulatory agencies approved a rulemaking requiring banks to replace the Current Exposure Method ("CEM") with the Standardized Approach to Counterparty Credit Risk ("SA-CCR") by January 1, 2022.[11] The Exchange believes CEM's primary flaws arise from the methodology's insensitivity to actual risk. For example, CEM does not account for the delta (i.e., market sensitivity) of an option position or fully recognize the offsetting of

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9 The Exchange notes Market-Makers participate on over 95% of SPX option trades on the Exchange.

10 Several TPHs have indicated to the Exchange that these rules could hamper their ability to provide consistent liquidity in the current SPX market, and have inquired about the ability engage in compression trading prior to the end of the current quarter.

11 Some TPHs have implemented SA-CCR while others have not.

positions with opposite economic exposures. The Exchange believes implementation of SA-CCR will help correct many of CEM's flaws by incorporating risk-sensitive principles, such as delta weighting options positions and more beneficial netting of derivative contracts that have economically meaningful relationships. This means that SA-CCR will be less penal to CTPHs (and the market participants for which they clear options positions) than CEM as it relates to options positions. However, the implementation of SA-CCR will not eliminate the need for market-makers to manage their positions or be concerned about the accumulation of cleared positions that ultimately contribute to risk weighted asset requirements of their clearing firms and thus the capital ratios with which those firms need to comply.

The Exchange notes there are very few clearing banks, and even fewer that clear for options market-makers. Increased clearing of over-the-counter products, such as swaps, by these same clearing banks means there is a risk of less available clearing bandwidth for listed options, even with the adoption of SA-CCR. Additionally, market-makers will continue to hold positions that are virtually riskless but have a significant capital impact that could be compressed in order to free up balance sheets to enable market-makers to continue to provide meaningful liquidity to the market. Therefore, even when all banks have implemented SA-CCR, the Exchange believes compression will continue to be a valuable tool for market participants.[12]

From March 16 to June 12, 2020, the Exchange's trading floor was closed due to the coronavirus pandemic. During that time, the Exchange operated in an all-electronic configuration, which would have prevented market participants from reducing open SPX interest in open outcry compression forums. As a result, the Exchange adopted current Rule 5.24(e)(1)(E) to permit TPHs to reduce open interest in SPX options in electronic compression

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12 The Exchange notes another market offers its members a compression tool for a competitive product. See Chicago Mercantile Exchange, Inc. ("CME") Rule 857.

forums while the trading floor was closed.[13] When the trading floor reopened on June 15, 2020, electronic compression forums were no longer available. However, the Exchange received feedback from customers while the floor was closed and since the floor has reopened regarding the benefits of the electronic compression forums, including the efficiency it provided with respect to the execution of the orders via an unexposed cross and the flexibility to effect these executions at more times than currently available in open outcry. In addition to verbal feedback the Exchange received, in early May, the Exchange received a letter signed by seven TPHs noting the increased efficiency in execution of compression trades the electronic compression forums provided and requesting permanent approval of daily electronic compression. The firms noted the significance of the functionality for evaluation of their risks and capital needs. Additionally, the firms noted daily compression using the electronic functionality then-available permitted them to respond to intra-month reviews of regulatory capital necessary for their positions by clearing firms, to which firms are unable to respond in real-time using the current open outcry compression forums. Therefore, the Exchange proposes to adopt Compression orders that can be executed electronically or in open outcry on a permanent basis via unexposed crosses.

The proposed rule change defines "Compression" or "PCC" order in Rule 5.6(c) as an order in SPX option contracts that may execute without exposure pursuant to Rules 5.32, 5.33, or

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[13] Pursuant to current Rule 5.24(e)(1), electronic compression forums would be available until August 31, 2020 when the trading floor is inoperable. Because the proposed rule change proposes to adopt Compression Orders on a permanent basis, the proposed rule change deletes the temporary electronic compression forum rule in Rule 5.24(e)(1)(E). Additionally, because the proposed definition of Compression Orders and the proposed provisions regarding the execution of Compression Orders include the same information as set forth in current Rule 5.88 regarding compression forums, the proposed rule change deletes Rule 5.88.

5.88 against another Compression order(s) totaling an equal number of option contracts.[14] A Trading Permit Holder may use Compression orders only to reduce the capital associated with its open SPX positions. Current Rule 5.88 specifies when compression forums may occur.[15] As proposed, as was the case for electronic compression forums while the trading floor was closed, the Exchange will announce the times at which TPHs may submit compression-list positions and at which the Exchange will make compression-list positions files available to TPHs.[16] The Exchange will provide TPHs with reasonable, sufficient notice of the timing at which lists must be submitted (as described in Rule 1.5), as well as when the Exchange will provide the lists of offsetting positions (as further discussed below). As further discussed below, a TPH may not include a closing SPX position in a Compression order unless it previously includes that position on a compression list provided to the Exchange in accordance with the required timeframe.[17]

While the Exchange intends to accept compression-list positions and make individual position files available at the end of each calendar week, month, and quarter, as it currently does, the Exchange believes it will be beneficial to offer TPHs the ability to compress their open positions more frequently. For example, while the trading floor was closed, the Exchange engaged in this process daily due to the volatility present at the time, which resulted in market

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14 This is substantially similar the definition in Rule 5.24(e)(1).

15 See Rule 5.88(a)(6) (compression forums occur on the last business day of each calendar week, each of the last three business days of each calendar month, and each of the last five business days of each calendar quarter). Pursuant to Rule 1.5, the Exchange will announce the times when the execution of Compression orders may occur.

16 See current Rule 5.24(e)(1)(E)(i).

17 For example, if the Exchange indicates it will accept compression lists and provide individualized lists on a daily basis, if a TPH identifies a position it would like to compress intraday but did not submit it on a compression list the prior day (as required by the Exchange), the TPH could not submit that position in a Compression order that day. Instead, it could submit a compression list that day and then include it in a Compression order the following trading day.

participants, particularly market-makers, taking on positions in a larger range of strikes than they would during normal market conditions due to the sharp swings in the value of the S&P 500 Index.[18] As noted above, TPHs believed the ability to compress more frequently enabled them to more adequately and efficiently respond to intra-month reviews by their clearing firms of regulatory capital necessary for their open positions. The proposed flexibility will permit the Exchange to react to market conditions and facilitate TPHs' reduction of SPX open interest in response to volatility as necessary, such as during times of extreme market volatility when the ability to close open interest to alleviate bank regulatory capital requirements is particularly important.

As is the case with current open outcry compression forums, all TPHs (or their CTPHs on their behalf)[19] may submit lists of open positions ("compression-list positions") to the Exchange that they wish to close against opposing (long/short) positions of other TPHs using Compression orders.[20] The proposed rule change streamlines the process of how the Exchange will make information regarding offsetting positions and multi-leg positions available. The Exchange will continue to determine the size of offsetting compression list positions, including combinations of offsetting multi-leg positions, and send individual positions files to each TPH that submitted

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18 See Cboe Options Exchange Notice C2020033103, issued May 31, 2020.

19 The Exchange understands the CTPHs coordinate with market participants for which they clear positions regarding the positions CTPHs may wish to close on those market participants' behalf in accordance with their clearing relationship. The Exchange notes the current rule permits OCC to also submit lists on behalf of TPHs. However, the Exchange understands that occurs only upon the direction of TPHs, rather than upon any initiative taken by OCC. In other words, OCC may provide a list to the Exchange in an administrative capacity at the directive of a TPH. Therefore, the proposed rule change deletes from the rule the ability of OCC to submit a list to the Exchange on behalf of a Trading Permit Holder, because OCC does not make any substantive determinations regarding what positions should be compressed.

20 See proposed Rule 5.6(c), subparagraph (1)(A) of definition of Compression order; see also current Rule 5.88(a)(1).

compression-list positions to the Exchange.[21] Currently, pursuant to Rule 5.88(a)(2), the Exchange makes available to all TPHs (on the Exchange website) a list including the size of the offsetting compression-list positions (including multi-leg positions) in each series (and multi-leg position) for which both long and short compression-list positions were submitted to the Exchange ("compression-list positions file"). The Exchange has identified no added value from the public posting of this list, as it has observed the TPHs that participate in the open outcry compression forums are those that submit the compression-list positions. All TPHs will continue to be able to submit compression-list positions and thus have access to the compression-list positions file if they submit compression-list positions, so the Exchange no longer believes it is necessary to post the list on its website. Additionally, the Exchange will no longer send the compression-list positions file to each TPH that submitted compression-list positions to the Exchange. The Exchange understands from TPHs that the individual position file, which shows offsetting size for their single and multi-leg positions, provides them with the information they seek by participating in the compression forums. Therefore, the Exchange believes it is no longer necessary to create and disseminate this separate list.

Because TPHs that participate in compression forums generally consent to having their identities disclosed to other participating TPHs, the Exchange also proposes to eliminate the steps of initially providing the individual position files on an anonymous basis and then requiring TPHs to consent to having their identities disclosed, as it is no longer necessary.[22] Instead, the

21 See proposed Rule 5.6(c), subparagraph (1)(B) of definition of Compression order; see also current Rule 5.88(a)(4).

22 See proposed Rule 5.6(c), subparagraph (1)(B) of proposed definition of Compression order; see also current Rule 5.88(a)(4) and (5). Because these lists will no longer be anonymous, the Exchange no longer believes it is necessary to separate provide a list of TPHs that submitted compression-list positions, which was provided only so that TPHs

individual position files the Exchange distributes will identify the TPHs that hold offsetting positions. TPHs generally submit compression-list positions with the goal of identifying other TPHs with offsetting positions that will enable them to engage in compression transactions. Including the identities of those TPHs at the outset is therefore consistent with the goal of compression forums and the proposed Compression orders and more efficient than the current process.

Pursuant to proposed subparagraph (1)(B) in the definition of Compression order, the information the Exchange will include in the individual position files it sends to each TPH that submitted compression-list positions to the Exchange the same information the Exchange provides pursuant to current Rule 5.88(a)(4), as well as two types of additional information regarding compression positions. First, the file will also include series positions within a strike range determined by the Exchange. Currently, the Exchange provides information (including offsetting positions of other TPHs) for various multi-leg positions. This additional information is a list of single-leg positions and offsetting positions of other TPHs. The Exchange provided this series information in addition to multi-leg information while the trading floor was closed. The Exchange believes this additional information will permit TPHs to create larger packages of positions that may be compressed.[23] Second, the individual positions file will also include combos (i.e., purchase (sale) of a call and a sale (purchase) of a put with the same expiration date and strike price), in addition to the currently provided multi-leg positions of vertical call spreads, vertical put spreads, and box spreads.[24] The Exchange included combos in the files it provided

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could reach out to those TPHs to see if they had the offsetting positions. Therefore, it is deleting that provision. See current Rule 5.88(a)(3).

23 See current Rule 5.24(e)(1)(E)(ii).

24 See proposed Rule 5.6(c), subparagraph (1)(B) of proposed definition of Compression order.

to TPHs when electronic compression forums were available.[25] Because a combo is essentially a "synthetic future," it is a common multi-leg strategy among market participants. Market participants often establish market neutral hedges by purchasing (selling) a number of combos with an offsetting SPX option position.[26] As a result, market participants maintain a significant number of combos in their portfolios. Additionally, when markets are volatile (as they were earlier in 2020), market participants often take on positions in a larger range of strikes, which positions can be put together as combos.

The Exchange believes closing combo positions will be advantageous because such positions can be risk neutral, which means the closing of the entire combo has little or no impact on a TPH's risk profile. However, the current compression forum framework limits multi-leg positions to vertical call[27] and put[28] spreads and boxes. The Exchange notes that just as one put spread and one call spread combine to create a box spread, two combos similarly create a box spread.[29] For example, a box spread would be entered by purchasing 100 DEC 2040 calls and selling 100 DEC 2070 calls (i.e., bull call spread) and selling 100 DEC 2040 puts and purchasing 100 DEC 2070 puts (i.e., bear put spread). The purchase of 100 DEC 2040 calls and sale of 100 DEC 2040 puts comprises a combo (as does the sale of 100 DEC 2070 calls and purchase of 100

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25 See current Rule 5.24(e)(1)(E)(iv); see also current Rule 5.88, Interpretation and Policy .01, which lists what multi-leg position strategies are currently made available in the files.

26 See, e.g., Rule 5.85(e).

27 A vertical call spread involves the purchasing and selling of an equal number of call options with the same expiration date but different strike prices.

28 A vertical put spread involves the purchasing and selling of an equal number of put options with the same expiration date but different strike prices.

29 A box spread involves purchasing (selling) a bull call spread and purchasing (selling) a bear put spread. In other words, a box spread is composed of a long (short) call and short (long) put position at one strike price and a short (long) call and long (short) put position at another strike price.

DEC 2070 puts). The Exchange believes that providing TPHs with this additional way to identify multi-leg positions with offsetting interest will enable more efficient closing of such common strategy positions and is merely providing information regarding positions TPHs are seeking to close that is already including in these lists in a different form. Like the other multi-leg strategies currently covered by Rule 5.88, the Exchange will compile a list of possible combos.

The lists generated by the Exchange pursuant to the proposed definition of Compression orders are provided to TPHs for informational purposes only. Individual TPHs will continue to determine whether to submit compression-list positions and whether to submit Compression orders for execution. The Exchange's provision of the list does not constitute advice, guidance, a commitment to trade, an execution, or a recommendation to trade, as is the case today for open outcry compression forums.

Proposed subparagraph (1)(C) of the proposed definition of Compression order provides that to the extent a Clearing TPH submits compression-list positions with offsetting to the Exchange on behalf of a Trading Permit Holder(s), the Exchange will not include those positions on the individual position files the Exchange makes available pursuant to proposed subparagraph (1)(B). The Exchange understands from Clearing TPHs that they have their own ability to identify compressible positions among the TPHs for which they clear. As discussed above, the need for compression stems from the regulatory capital requirements applicable to CTPHs, which as a result may impose stricter position limits on the firms for which they clear. Therefore, CTPHs are well-positioned to know which positions of the firms for which they clear could be compressed in order for those firms to remain in compliance with the position limits imposed by CTPHs when they conduct their regulatory reviews. Because CTPHs are in a position to identify offsetting positions, it is unnecessary for those positions to be included in the individual lists that are distributed to other TPHs that submitted compression-list positions, which are intended to assist those TPHs to identify counterparties with offsetting positions. It may be counterproductive and potentially confusing for TPHs if the individual positions lists include positions for which no counterparty is being sought. While the Exchange initially implemented compression forums to assist TPHs in finding counterparties with offsetting positions that were similarly seeking to compress positions, the Exchange believes expanding the use of Compression orders to CTPHs in this manner will provide them with more efficient means to comply with regulatory capital rules and permit the firms for which they clear to have access to liquidity to provide to the market. The Exchange believes it is still appropriate for CTPHs to submit compression-list positions prior to using Compression orders so that the Exchange may review those positions to determine they are for the purpose of compression.

Proposed subparagraph (2) of the proposed definition of Compression order permits Compression orders to be entered in $0.01 increments and permits the legs of complex Compression orders to be executed in $0.01 increments. This is consistent with the increment currently available for closing transactions in open outcry compression forums. As discussed below, complex orders in any ratio are permitted to be executed in open outcry compression forums, so the proposed rule change does not expand the complex order strategies that may trade in pennies for compression purposes. The proposed rule change will permit open positions in Compression orders to be entered and executed in pennies, unlike in current open outcry compression forums, which requires any opening transactions to be executed in the standard increment for SPX. The Exchange believes this is appropriate given that opening positions may partly comprise Compression orders as long as the total order is net position closing or neutral (as discussed below), and legs of single orders are systematically unable to be input or executed in different minimum increments. Additionally, the Exchange believes it may be confusing to have different portions of orders trade in different increments. The Exchange notes if a TPH opens a position using a Compression order, it would only be able to close that position using the standard increment for the class (unless it closes it using a Compression order, subject to the proposed requirements of that order type in this proposed rule change).

Unlike in compression forums, where persons can negotiate leg pricing to accommodate the current rule, such negotiation is not available in electronic trading. While the proposed rule change may increase the number of SPX contracts that may trade in pennies, given that a Compression order that will open any positions must be net position closing or neutral (as discussed below), the Exchange expects the majority of contracts that will benefit from this provision will be ones that close positions, as is the case today. As noted above, the Exchange believes permitting Compression orders to be partially comprised of opening positions will increase amount of open SPX interest TPHs are willing to close, and penny pricing for all contracts in Compression orders will further encourage closing of these positions. Because many series the Exchange expects TPHs will attempt to close will be out-of-the-money, and essentially worthless, TPHs may not otherwise close positions in these series if a higher minimum increment causes the price to be too much higher than the option's value. The Exchange believes it is reasonable to permit these orders to be entered and executed in penny increments to provide flexibility that will enable TPHs to maximize the number of open SPX positions they can close using Compression orders.

The proposed rule change will also permit a complex Compression order to have any ratio.[30] Currently, complex orders with any ratio may execute on the trading floor, including in open outcry compression forums (and thus they may execute in pennies); however, complex orders with a ratio of greater than three-to-one (except for Index Combos, which may have a ratio of up to eight-to-one combo) are not currently permitted to execute electronically.[31] Additionally, in open outcry (including in compression forums), complex orders with a ratio of less than one-to-three or greater than-three-to-one (except for Index Combos) do not receive complex order priority benefits and instead must execute at prices for which each leg betters any priority customer order on the Book rather than improve one leg.[32] As noted above, complex Compression orders may only execute if no leg executes at the same price as a priority customer order in the simple book,[33] and thus will be subject to the same priority as larger-ratio complex orders submitted in compression forums today. Therefore, permitting complex Compression orders with any ratio to execute electronically or in open outcry is consistent with current execution opportunities for complex orders in open outcry compression forums, and merely extends these execution opportunities to electronic compression trading. This proposed provision will therefore not result in any additional orders trading ahead of priority customer orders resting in the book.

One key characteristic of complex compression transactions is that they are intended to close open interest to alleviate bank regulatory capital requirements while bearing little, if any, market risk. As a result, market participants often minimize the net delta of the compression

30 See proposed Rule 5.6(c), subparagraph (2) of proposed definition of Compression order.

31 See Rule 1.1, definition of complex order.

32 See Rule 5.85(b).

33 See proposed Rule 5.33(n) and 5.85(j). Note the Exchange proposes to add Rule 5.33(m) in rule filing SR-CBOE-2020-060.

strategy (i.e., create a package with a delta of zero or near zero). Delta is the ratio comparing the change in the price of the underlying asset to the corresponding change in the price of a derivative. For example, if an index option has a delta value of 0.65, this means that if the underlying index increases in value by 1, the price of the option will increase by $0.65, all else equal. Delta values can be positive or negative depending on the type of option. For example, the delta for a call option always ranges from 0 to 1, because as the underlying asset increases in price or value, call options increase in price. Put option deltas always range from -1 to 0 because as the underlying asset increases in price or value, the value of put options decrease. For example, if a put index option has a delta of -0.33, if the value of the underlying index increases by 1, the price of the put option will decrease by $0.33. Generally speaking, an at-the-money option usually has a delta of approximately 0.5 or -0.5.

In order to minimize the delta of a compression strategy, the Exchange understands that market participants often include combos[34] to offset any residual delta that the other legs may create. For example, suppose two market participants seek to execute a transaction to close their respective offsetting positions in a spread containing 100 contracts of SPX Series A and 100 contracts of SPX Series B, which has a net delta of 0.02. In order to offset this minimal delta, the market participants include two contracts of an SPX combo with a mutually agreed upon expiration and strike price. The addition of these combos neutralizes the delta market risk of the positions to be compressed but creates a package with a ratio of 50-1. Orders with this ratio may currently execute in open outcry but may not execute electronically. The Exchange believes permitting all complex orders with any ratio to be submitted as Compression orders will provide

34 As described above, a "combo" is a purchase (sale) of a call and a sale (purchase) of a put with the same expiration date and strike price, which is essentially a "synthetic future" and a common multi-leg strategy among market participants.

TPHs with additional flexibility to close open interest to eliminate as much regulatory capital associated with their portfolios as possible while minimizing any possible associated risk. Additionally, it is consistent with permissible executions in current open outcry compression forums.

Proposed subparagraph (3) of the definition of Compression order provides that a Compression order may be comprised of all closing positions or a combination of opening and closing positions as long as it is net position closing or neutral. In other words, the number of contracts in closing positions must be larger than or equal to the number of contracts in opening positions.[35] Any closing position submitted as part of a Compression order must have been included in a compression-position list submitted to the Exchange, and Compression orders may be used solely for the purpose of reducing required capital associated with TPH's positions. The Exchange believes requiring closing positions included in compression-list positions to be submitted to the Exchange on compression position lists will create an additional control to limit use of Compression orders for legitimate compression purposes. The proposed rule change is similar to current open outcry compression forums, which permit opening orders to execute against closing orders. The goal of compression is for market participants to close open interest to reduce regulatory capital attributable to those positions. However, permitting a TPH to include opening positions in Compression orders may still result in a reduction of regulatory capital necessary for a TPH's positions, even if it opens new positions, which will provide TPHs with additional flexibility to maximize its reduction in required regulatory capital. The files the Exchange makes available are intended to provide potential offset opportunities for TPHs

[35] If the contra-side Compression order is comprised of orders from multiple contra-parties, the positions for each contra-party must be net position closing or neutral. This is consistent with the goal of compression, which is to reduce the regulatory capital attributable to positions of a specific market participant.

looking to compress open SPX positions. However, TPHs often do not have the same number of offsetting positions to complete a risk neutral compression transaction. For example, TPH 1 might have an offsetting position with TPH 2 in three out of four series that comprise a box spread. By trading a box spread, which is risk neutral, the TPHs can substantially reduce the regulatory capital attributable to the three series that offset while only needing to open positions in one series in which they did not have existing position. As another example, a TPH may determine it is necessary to add a combo position when attempting to close other positions in order to flatten the delta risk of a compression trade. To do so, a TPH may need to open a position in one series of the combo it and another TPH do not have offsetting positions for that combo. The Exchange believes permitting TPHs to include opening positions may provide more opportunities to close open interest to alleviate bank regulatory capital requirements attributable to their open positions using Compression orders than if they were restricted to only closing positions.

The Exchange believes permitting TPHs to include opening positions may provide additional opportunities to reduce more regulatory capital attributable to their portfolios using Compression orders than if they were restricted to only closing positions. The requirement that Compression orders be net position closing or neutral is consistent with the goal of compression, which is to close open interest to alleviate bank regulatory capital requirements attributable to their portfolios. If an order is net closing, then more positions will be closed than opened, ultimately reducing the regulatory capital associated with the positions of the TPH.

While regulatory capital reduction may be achieved with the closing of positions, it may also be achieved by "swapping" open positions with new positions with which there is lower regulatory capital associated. The Exchange understands TPHs may do this for risk management purposes. Specifically, TPHs retain certain options positions in their portfolios for hedging and risk exposure purposes. However, the calculation of regulatory capital associated with options positions involves a complex formula, but it ultimately is calculating an amount based on the quantity of a position times the strike price (which is why the large notional value of SPX options has created issues for TPHs). Therefore, an option position with a lower strike price will likely have lower regulatory capital associated with that position than regulatory capital associated with a higher strike price. A market participant may identify options with lower strikes that provide it with substantially similar risk exposure as some of its open positions while maintaining a hedge within its portfolio. Merely closing such higher-strike positions may reduce the required capital associated with the market participant's portfolio, but such closure may leave portions of that portfolio unhedged and thus subject to higher risk. By "swapping" its current open positions in options with higher strikes with positions in options with lower strikes (often using boxes and combos), a market participant may maintain the same risk exposure in its portfolio while replacing higher-strike positions with lower-strike positions in order to swap related exposures. For example, suppose a TPH has 100 contracts in an SPX box spread with October expiration and strike prices of 3500 and 3600. Suppose another TPH has 100 contracts for the offsetting box spread, but also want to buy 100 contracts in an SPX box spread with October expiration and strike prices of 1500 and 1600. Each TPH in this close would be opening positions in 400 contracts as well as closing positions in 400 contracts, making each side net position neutral. While each TPH would have the same number of open positions after this transaction, the regulatory capital associated with each TPH's positions would be significantly reduced given the newly opened positions have strike prices 2000 lower than the closed positions. Execution of this transaction would be riskless and would provide meaningful regulatory capital relief to the TPHs. Ultimately, transactions like this are essentially riskless exchanges that carry no profit or loss for market participants, but rather are intended to provide a seamless method for market participants to reduce margin and capital requirements while maintaining the same risk exposure within their portfolios.[36]

Currently, TPHs may only execute compression transactions in open outcry compression forums in accordance with open outcry trading rules, except that opening transactions in SPX option could not execute against opening transactions through a compression forum, and only closing transactions could be executed in $0.01 increments.[37] In accordance with standard open outcry trading rules, a floor broker would represent a cross of orders representing this interest to the trading crowd. While other in-crowd market participants have the opportunity to respond and participate in the transaction, generally the orders represented in the cross execute cleanly against each other.

The proposed rule change will permit Compression orders to be executed electronically and in open outcry as unexposed clean crosses.[38] While orders in open outcry compression

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36 The Exchange notes TPHs similarly swap exposures in order to reduce capital and margin requirements by exchanging positions in options with positions in future. <u>See</u> SR-CBOE-2020-060 (the Exchange's recent proposal to adopt related futures cross ("RFC") orders (which were recently adopted by another options exchange), which would provide market participants with an additional mechanism to reduce required capital associated with their positions while maintaining risk exposure within their portfolios).

37 <u>See</u> current Rule 5.88(b).

38 <u>See</u> proposed Rules 5.30(a)(2) and (b)(2), 5.33(c), 5.70(a)(2), and 5.83(a)(2) and (b)(2). Unlike current compression forums, which are restricted to Regular Trading Hours, electronic Compression orders may be executed during Regular or Global Trading Hours, as the Exchange makes electronic trading of SPX options available during Global Trading Hours. This will provide TPHs with additional flexibility regarding when they may execute Compression orders and related capital that may be put back into the market. FLEX SPX options may currently be executed in open outcry compression forums, and the proposed rule change clarifies the availability of Compression orders for FLEX SPX options, which will execute in the same manner as Compression orders for

forums are currently required to be exposed, they generally execute as clean crosses. Therefore, permitting Compression orders to execute as clean crosses replicates how SPX orders generally execute in open outcry compression forums. As proposed, a Compression order with one leg submitted for electronic execution will execute automatically on entry without exposure if the execution price: (a) is not at the same price as a Priority Customer order resting in the Book; and (b) is at or between the national best bid or offer ("NBBO").[39] This provision provides that Compression orders with single legs submitted for electronic execution must execute in accordance with the same priority principles that apply to all other simple orders on the Exchange, which protects Priority Customer orders in the simple book and prohibits trades through prices available in the book. A Compression order with multiple legs submitted for electronic execution will execute automatically on entry without exposure if: (1) each option leg executes at a price that complies with Rule 5.33(f)(2),[40] provided that no option leg executes at the same price as a Priority Customer Order in the Simple Book; (2) each option leg executes at a price at or between the NBBO for the applicable series; and (3) the execution price is better than

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non-FLEX SPX options. See Rule 5.72(a), which provides that trading of FLEX Options is subject to all other Rules applicable to the trading of options on the Exchange, unless otherwise provided in Chapter 5, Section F of the Rules. Since Compression orders will not be exposed, as proposed, FLEX Compression orders would execute in the same manner as opposed to in a FLEX Auction pursuant to Rule 5.72.

39 See proposed Rule 5.32(g).

40 Rule 5.33(f)(2) requires complex orders to execute only if the execution price: at a net price: (1) that would cause any component of the complex strategy to be executed at a price of zero; (2) worse than the synthetic best bid or offer ("SBBO") or equal to the SBBO when there is a Priority Customer Order at the SBBO, except all-or-none complex orders may only execute at prices better than the SBBO; (3) that would cause any component of the complex strategy to be executed at a price worse than the individual component prices on the Simple Book; (4) worse than the price that would be available if the complex order Legged into the Simple Book; or (5) that would cause any component of the complex strategy to be executed at a price ahead of a Priority Customer Order on the Simple Book without improving the BBO of at least one component of the complex strategy.

the price of any complex order resting in the COB, unless the submitted complex order is a Priority Customer Order and the resting complex order is a non-Priority Customer Order, in which case the execution price may be the same as or better than the price of the resting complex order.[41] This provision provides that Compression orders with multiple legs submitted for electronic execution may only execute if they provide additional protection to Priority Customer orders on the Simple Book compared to other "standard" complex order executions, as Compression orders may only execute if no leg trades at the same price as a customer order on the book rather than just improving one leg (which priority principles require for other electronic complex order executions). The System cancels a Compression order if it cannot execute.[42] Therefore, if an order cannot execute in accordance with the execution price and priority requirements described above, it will be cancelled.

Similarly, proposed Rule 5.85(j)[43] describes how Compression orders submitted for open outcry execution will execute. A Compression order with a single leg will execute without representation on the trading floor if it executes at a price that is not at the same price as a Priority Customer order resting on the Book and is at or between the NBBO. These are the same proposed execution price requirements for electronic Compression orders with a single leg and are also the same as the priority principles that apply to all other simple orders executed on the trading floor, which protects Priority Customer orders in the simple book and prohibits trades through prices available in the book.[44] A Compression order with multiple legs will execute without representation on the trading floor if: (1) each option leg executes at a price that

41 See proposed Rule 5.33(n).

42 See proposed Rules 5.32(g)(1) and 5.33(n)(1).

43 The Exchange proposes to add Rule 5.85(i) in rule filing SR-CBOE-2020-060.

44 See Rule 5.85(a).

complies with Rule 5.85(b),[45] provided that no option leg executes at the same price as a Priority Customer Order in the Simple Book; (2) each option leg executes at a price at or between the NBBO for the applicable series; and (3) the execution price is better than the price of a complex order resting in the COB, unless the Compression order is a Priority Customer Order and the resting complex order is a non-Priority Customer Order, in which case the execution price may be the same as or better than the price of the resting complex order. Like the execution and priority requirements described above for electronic complex Compression orders, this proposed provision provides that complex Compression orders with multiple legs submitted for open outcry execution must execute in accordance with the same priority principles that apply to all other complex orders executed on the trading floor on the Exchange, except that additional protection will be provided for Priority Customer Orders in the Simple Book (the proposed priority principle is the same as the priority applicable to larger-ratio complex orders executed in open outcry). As a result, this proposed provision protects Priority Customer orders in the simple book and COB and prohibits trades through prices available in the book. A Compression order may not be executed in open outcry unless these criteria are satisfied. While open outcry Compression orders do not need to be represented on the trading floor, executions of such orders

45 Pursuant to Rule 5.85(b), a complex order (1) with any ratio equal to or greater than one-to-three (.333) and less than or equal to three-to-one (3.00) or (2) that is an Index Combo order may be executed at a net debit or credit price without giving priority to equivalent bids (offers) in the individual series legs that are represented in the trading crowd or in the Book if the price of at least one leg of the order improves the corresponding bid (offer) of a Priority Customer order(s) in the Book by at least one minimum trading increment as set forth in Rule 5.4(b). A complex order with any ratio less than one-to-three (.333) and greater than three-to-one (3.00) (except for an Index Combo order) may be executed in open outcry on the trading floor at a net debit or credit price without giving priority to equivalent bids (offers) in the individual series legs that are represented in the trading crowd or in the Book if each leg of the order betters the corresponding bid (offer) of a Priority Customer order(s) in the Book on each leg by at least one minimum trading increment as set forth in Rule 5.4(b).

will be systematically recorded and reported by TPHs in the same manner they currently record and report open outcry transactions.

Generally, in SPX options (and other classes), the Exchange lists series with narrower strike intervals that are closer to the at-the-money value, and with wider strike intervals that are further from the at-the-money value. The Exchange's internal listing procedures are intended to balance the need to list sufficient strikes to provide market participants with flexibility to manage their risk with Market-Makers' quoting obligations. The Exchange recently reviewed and modified these procedures for SPX options in an effort to reduce the number of listed strikes in a manner intended to permit Market-Makers to further reduce regulatory capital attributable to their SPX open interest (and thus free up capital to continue to provide liquidity).[46]

The proposed rule change moves the provision regarding solicitation in current Rule 5.88(c) to subparagraph (4) of the proposed definition of Compression order in Rule 5.6(c) with no substantive changes, and thus that provision will apply to Compression orders in the same manner it applies to compression forums, as the process for providing compression position lists and files will generally be the same. Proposed subparagraph (5) of the proposed definition of Compression order in Rule 5.6(c) also provides that Rule 5.9 (related to exposure of orders on the Exchange) will not apply to executions of Compression orders, as they will be able to execute without exposure, as discussed above.[47]

Pursuant to the proposed rule change, Compression orders will be identified as such when submitted into the System for execution. As a result, the Exchange's Regulatory Division

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46 While SPX options are listed for trading exclusively on Cboe Options, it competes with other listed options, such as options on the SPDR S&P 500 exchange-traded fund.

47 See current Rule 5.24(e)(1)(E)(iii)(b).

intends to put in place a regulatory review plan that will permit it to ensure any Compression orders are submitted and executed in accordance with the proposed rule.

The Exchange understands from customers, and SPX Market-Makers in particular, that there continues to be significant need to reduce regulatory capital attributable to their open interest based on then-current market conditions. These market participants regularly avail themselves of open outcry compression forums when available, in which they use the information provided in the Exchange-provided position lists to identify potential counterparties that similarly need to close SPX open interest. Providing TPHs, and Market-Makers in particular, with the ability to more efficiently close or exchange SPX open interest using this Exchange-provided information, either electronically or in open outcry, will provide them with additional flexibility to obtain needed relief from the effect of bank regulatory capital requirements on the options market at more times than are currently available and either electronically or in open outcry. As noted above, because some CTPHs carrying these are bank-owned broker/dealers, those CTPHs are subject to further bank regulatory capital requirements, which result in these additional punitive capital requirements being passed on to their market-maker clients.[48] Such flexibility is particularly true during times of extreme volatility, such as the recent the historic levels of market volatility, which can make providing liquidity in SPX options immensely more challenging. The Exchange believes use of Compression orders to close or exchange open SPX interest in order to alleviate bank regulatory capital requirements may be more efficient and effective than current open outcry compression forums, given that orders generally execute in compression forums as clean crosses.

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48 See Letter from Cboe, New York Stock Exchange, and Nasdaq, Inc., to the Honorable Randal Quarles, Vice Chair for Supervision of the Board of Governors of the Federal Reserve System, March 18, 2020.

The Exchange believes the proposed rule change to expand and enhance functionality currently only available on the trading floor will allow liquidity providers to execute trades to reduce regulatory capital attributable to SPX open interest in a substantially similar manner as they are currently able to in open outcry compression forums. The Exchange believes Compression orders will assist TPHs to more efficiently and effectively reduce any potential negative impact on the market-making community that may result from bank regulatory capital requirements, which could reduce liquidity available in an extremely volatile market when the market needs this liquidity the most. The Exchange believes the proposed rule change will eliminate certain existing inefficiencies that exist in current open outcry compression forums, which the Exchange expects will free up liquidity providers' much needed capital, which will benefit the entire market and all investors.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Securities Exchange Act of 1934 (the "Act") and the rules and regulations thereunder applicable to the Exchange and, in particular, the requirements of Section 6(b) of the Act.[49] Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)[50] requirements that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. Additionally, the Exchange believes the proposed rule change

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49 15 U.S.C. 78f(b).

50 15 U.S.C. 78f(b)(5).

is consistent with the Section 6(b)(5)[51] requirement that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

In particular, the Exchange believes the proposed rule change will remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, protect investors and the public interest because it seeks to further mitigate the potentially negative effects of the bank capital requirements on liquidity in the SPX markets. As described above, current regulatory capital requirements could potentially impede efficient use of capital and undermine the critical liquidity role that Market-Makers and other liquidity providers play in the SPX options market by limiting the amount of capital CTPHs allocate to clearing member transactions. Specifically, the rules may cause CTPHs to impose stricter position limits on their clearing members. In turn, this could force Market-Makers to reduce the size of their quotes and result in reduced liquidity in the market. The Exchange believes that permitting TPHs to close SPX options positions to reduce regulatory capital attributable to their portfolios will permit to contribute to the availability of liquidity in the SPX options market and help ensure that these markets retain their competitive balance. The Exchange believes that the proposed rule would serve to protect investors by helping to ensure consistent continued depth of liquidity, particularly given current market conditions when liquidity is needed the most by investors.

The proposed rule change will provide liquidity providers and other market participants with the ability to reduce regulatory capital attributable to their open interest in SPX options electronically or in open outcry in a substantially similar manner as they are able to do on the trading floor. The proposed flexibility with respect to when the Exchange will accept and make

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51 Id.

available lists of positions TPHs would like to compress will permit the Exchange to react to market conditions and facilitate TPHs' reduction of SPX open interest in response to volatility as necessary. Permitting Compression orders to be submitted for execution at any time will also provide TPHs with flexibility to complete these compression transactions in accordance with their own needs (as long as they previously submitted the applicable positions to be closed to the Exchange in advance), as well as to address intra-month position reviews by their CTPHs. The Exchange believes this enhanced compression process will allow market participants to reduce the necessary regulatory capital associated with their options positions and permit them to provide more liquidity in the market. This additional liquidity may result in tighter spreads and more execution opportunities, which benefits all investors, particularly in volatile markets.

Additionally, the Exchange believes the proposed rule change will 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 by adding information (combos and individual positions) to the lists the Exchange will make available to TPHs for informational purposes. The Exchange believes the additional information that may be provided to TPHs in compression forums may encourage TPHs to close additional positions via the compression process. With respect to the addition of combos, that information may enable TPHs to more efficiently and effectively close positions comprising a common multi-leg strategy in the SPX market via Compression orders, which, in general, helps to protect investors and the public interest because closing positions via the compression process serves to alleviate the adverse impact of bank capital requirements. The information regarding individual and combo positions is currently included in the compression position lists the Exchange provides to TPHs in different forms – the single leg positions are part of multi-leg strategies and combos are parts of box spreads. The proposed rule change merely provides the Exchange with the ability to list single leg positions and combo positions separately, which will provide TPHs with additional flexibility when locating counterparties with which to execute Compression orders. This may create opportunities for TPHs to compress additional positions, which frees up additional liquidity and ultimately benefits investors.

The Exchange also believes the proposed rule change is consistent with the Act, because the proposed compression process is a streamlined version of the current open outcry compression forums on the trading floor. It eliminates the provisions of compression-list positions files, which the Exchange understands were generally unused by TPHs. Additionally, it eliminates the additional steps the Exchange and TPHs must take to have TPHs names disclosed with their associated compression-list positions, as TPHs that currently participate in open outcry compression forums do not choose to remain anonymous. The Exchange understands that TPHs generally submit compression-list positions with the goal of identifying other TPHs with offsetting positions that will enable them to engage in compression transactions. Therefore, eliminating the ability to remain anonymous in the individual position files is consistent with the goal of Compression orders and more efficient than the current process. Submission of compression-list positions will constitute TPHs' consent to disclosure of their names and associated positions on the individual positions files. The Exchange believes the proposed rule will provide an enhanced and more efficient open outcry and electronic mechanism for compression of SPX open positions.

The Exchange believes the proposed rule change to exclude compression-list positions submitted by a Clearing TPH to the Exchange on behalf of a Trading Permit Holder(s) from the individual position files will further remove impediments to and perfect the mechanism of a free and open market and a national market system. As discussed above, the need for compression stems from the regulatory capital requirements applicable to CTPHs, which as a result may impose stricter position limits on the firms for which they clear. Therefore, CTPHs are well-positioned to know which positions of the firms for which they clear could be compressed in order for those firms to remain in compliance with the position limits imposed by CTPHs when they conduct their regulatory reviews. Because CTPHs are in a position to identify offsetting positions, it is unnecessary for those positions to be included in the individual position files, which are intended to assist those TPHs to identify counterparties with offsetting positions.[52] It may be counterproductive and potentially confusing for TPHs if the individual positions lists include positions for which no counterparty is being sought. While the Exchange initially implemented compression forums to assist TPHs in finding counterparties with offsetting positions that were similarly seeking to compress positions, the Exchange believes expanding the use of Compression orders to CTPHs in this manner will provide CTPHs with more efficient means to comply with regulatory capital rules and permit the firms for which they clear to have access to liquidity to provide to the market, which ultimately benefits all investors.

The proposed rule change imposes priority requirements that will protect Priority Customer orders and orders on top of the book that comprise the BBO. In fact, the proposed priority requirements for complex orders will provide customers orders in the book with additional protection with respect to electronic complex orders and smaller ratio complex orders in open outcry, as no leg of a Compression order may execute at the same price as any Priority Customer order on the Simple Book.

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52 The Exchange notes CTPHs can continue to submit compression position lists without a list of offsetting positions, in which case those positions would be included in the individual position files and assist those CTPHs with identifying TPHs with offsetting positions.

The proposed rule change is consistent with how compression transactions currently execute on the trading floor. The proposed rule change is replicating a procedure that is currently available to market participants only on the trading floor and enhances the current open outcry procedure. The proposed rule change will protect Priority Customer orders and orders on top of the book that comprise the BBO, as well as Priority Customer orders on the top of the COB, and thus will provide additional protection to customers on the book compared to other executions of orders on the Exchange. While orders are currently required to be exposed on the trading floor, the Exchange has observed that market participants generally defer their allocations to permit a clean cross, as that is necessary for these transactions to achieve their intended effect and not leave market participants with unhedged positions (and thus more risk). As a result, the lack of exposure of Compression orders will be practically consistent with how orders are currently executed in compression forums – it just eliminates the need to represent the orders on the floor, which representation during compression forums has been demonstrated to be unnecessary.

While orders in compression forums are currently required to be exposed to the trading crowd, the Exchange has observed that market participants generally deferred their allocations to permit a clean cross. Because orders that are executed in compression forums on the trading floor are generally not broken, and because the purpose of these trades is unrelated to profits and losses (making the price at which the transaction is executed relatively unimportant like competitive trades), the Exchange believes it is appropriate to not require exposure of these orders in an electronic or open outcry setting. As noted above, during the time the Exchange's trading floor was closed, the Exchange made Compression orders available to TPHs for immediate (and thus unexposed) electronic execution. The Exchange received feedback from several TPHs regarding the increased efficiency provided by electronic Compression orders, which feedback included requests to make Compression orders available when the trading floor reopened. The Exchange believes it is unlikely that TPHs on the trading floor would seek to break up the execution of Compression orders in the future, as several TPHs engage in compression to reduce capital attributable to the positions in their portfolio and would similarly expect to be able to execute their Compression orders without other TPHs breaking them up. The Exchange understands this type of mutual understanding among TPHs contributes to smoother operations on the trading floor. The Exchange also believes that TPHs understand the benefits that compression may bring to liquidity on the trading floor.

Even if TPHs decided to attempt to break up these orders in the future, the Exchange believes the benefits of permitting Compression orders to execute as clean crosses greatly outweigh any benefits that may result from exposing these orders for potential break up. The Exchange notes that the benefits of requiring a broker to expose an order on the trading floor generally flow to that order, which include the potential of price improvement for the order and to locate liquidity against which to execute the order. In the case of a Compression order, the representing broker has already located the necessary liquidity to execute the order, as that is necessary given the nature of these transactions. If TPHs believed it was reasonably possible that other TPHs in the trading crowd would break up Compression orders, those TPHs would not attempt to execute those orders on the trading floor (and thus there would be no orders for other TPHs to break up). If an electronic Compression order that immediately executes without exposure were available (as it was when the trading floor was closed), then TPHs would merely submit Compression orders for electronic execution. Permitting open outcry Compression orders will permit TPHs to cross these orders using the same tools they use to currently execute those orders.

It is critical that TPHs are able to efficiently manage capital and margin requirements so that they continuously have sufficient capital available to provide to the markets, which benefits all market participants, including those that may seek to break up Compression orders. Many TPHs clear through CTPHs that have been impacted by bank regulatory capital requirements, and therefore the Exchange believes all TPHs on the trading floor understand and respect the need of other TPHs to reduce capital attributable to their positions in accordance with capital reviews performed by CTPHs as efficiently as possible, including through the use of compression.

While the proposed rule change eliminates certain steps with respect to the compression files the Exchange provides, as discussed above, the Exchange believes these steps provide no current value to the process. As a result, the Exchange believes the proposed process is practically consistent with the current process. Because the changes create a process that is practically consistent with the current process, the Exchange does not believe they will have any negative impact on the ability of TPHs to effect compression transactions. The proposed rule change streamlines the process by eliminating steps that add no demonstrable value to the compression process and will enable TPHs to engage in compression transactions more efficiently.

The Exchange believes the proposed rule change to permit Compression orders to have any ratio will 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, as it will provide TPHs with the ability to maximize positions they may close while minimizing market risk. Currently in open outcry compression forums, complex orders may be executed in any ratio (and in pennies if closing positions). Because the proposed priority requirements are consistent with the open outcry complex order priority for larger ratio orders, the Exchange believes the proposed rule change will not disadvantage the simple order market, as no leg of a Compression order may execute at the same price as a resting Priority Customer order in the simple book.

The proposed rule change to permit the opening portions of Compression orders to be entered and executed in pennies will benefit investors, as it will eliminate potential confusion about different portions of different trades executing at different increments. The Exchange believes this is appropriate given that opening positions may partly comprise Compression orders as long as the total order is net position closing or neutral and legs of single orders are systematically unable to be input or executed in different minimum increments. The Exchange believes restricting use of Compression orders to positions intended to reduce required capital associated with a TPH's positions will limit the use of Compression orders, including the inclusion of opening positions in those orders, to the intended purpose of these orders. Additionally, the Exchange believes it may reduce potential investor confusion that may result from requiring different portions of orders to trade in different increments, if that were systematically possible. Unlike in compression forums on the trading floor, where persons can negotiate leg pricing to accommodate the current rule, such negotiation is not available in electronic trading. While the proposed rule change may increase the number of SPX contracts that may trade in pennies, given that a Compression order that will open any positions must be net position closing or neutral, the Exchange expects the majority of contracts that execute as part of Compression orders will be ones that close positions, as is the case today.

As noted above, the Exchange believes permitting Compression orders to be partially comprised of opening positions will increase amount of open SPX interest TPHs are willing to close, and penny pricing for all contracts in Compression orders will further encourage closing of these positions. Because many series the Exchange expects TPHs will attempt to close will be out-of-the-money, and essentially worthless, TPHs may not otherwise close positions in these series if a higher minimum increment causes the price to be too much higher than the option's value. The Exchange believes it is reasonable to permit these orders to be entered and executed in penny increments to provide flexibility that will enable TPHs to maximize the number of open SPX positions they can close using Compression orders. While the Exchange understands there may be a concern that market participants may attempt to use Compression orders to execute orders in pennies that would otherwise be required to execute in a larger increment, the Exchange believes this minimal risk is outweigh by the benefits the proposed rule change may provide to the market and all investors. Additionally, the Exchange believes the requirements that Compression orders be net closing or neutral and include closing positions previously submitted to the Exchange on compression position lists, and be for the purpose of reducing required capital associated with open positions will create additional controls to limit use of Compression orders for legitimate compression purposes that further minimizes this potential risk.

It is critical to the ongoing stability of the options markets that TPHs are able to efficiently manage capital and margin requirements so that they continuously have sufficient capital available to provide to the markets, which benefits all market participants, including those that may seek to break up Compression orders. As all TPHs are subject to capital and margin requirements, the Exchange believes all TPHs on the trading floor understand and respect the need of other TPHs to manage these requirements as efficiently as possible. The Exchange believes the proposed rule change, which is limited to one class the Exchange believes is being significantly impacted by bank regulatory capital requirements and the one class in which open outcry compression forums may currently occur, as well as limiting the use of Compression orders for reducing the required capital associated with a TPH's open SPX positions, is narrowly tailored for the specific purpose of facilitating the ability of liquidity providers to alleviate the negative effects of current bank regulatory capital requirements. The Exchange believes the proposed rule change will protect investors by providing a more seamless execution of compression transactions and thus facilitate a more efficient way for liquidity providers to meeting their capital requirements, which will protect investors by contributed to the continued depth of liquidity in the SPX options market.

Based on activity in open outcry compression forums and the number of orders executed in electronic compression forums when the trading floor was closed, the Exchange believes it has sufficient system capacity to handle any additional traffic that may result from the proposed rule change. The Exchange's Regulatory Division intends to incorporate Compression orders into its surveillances.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange does not believe the proposed rule change will impose any burden on intramarket competition, as Compression orders will be available to all market participants with SPX open interest. As discussed above, while the proposed rule change is directed at market-makers, all market participants may submit Compression orders in the same manner as long as all criteria of the proposed rule are satisfied. While compression-list positions submitted by CTPHs on behalf of TPHs for which they clear will no longer be included in individual position files, the Exchange believes this is appropriate given that bank regulatory capital requirements apply to CTPHs, who are therefore positioned to identify offsetting positions among TPHs for which they clear that will enable them to more efficiently comply with those requirements. Ultimately, this still benefits TPHs on whose behalf CTPHs submit compression-list positions, as the resulting compression transactions will result in the ability of those TPHs to provide additional liquidity to the market.

The Exchange does not believe the proposed rule change will impose any burden on intermarket competition, as it will apply only to SPX options, which are currently listed for trading only on the Exchange. Additionally, open outcry compression forums are currently limited to SPX options. In addition, the proposed rule change is intended create a more efficient effective mechanism for market participants to close SPX option interest to reduce regulatory capital attributable to their portfolios. Compression orders are not seeking price improvement but rather looking to free up capital that will permit those parties to continue to provide liquidity to the market, and thus is not intended to have a competitive impact.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The Exchange neither solicited nor received comments on the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

A. by order approve or disapprove such proposed rule change, or

B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-CBOE-2020-074 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-2020-074. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, 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-2020-074 and should be submitted on or before [insert date 15 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[53]

Jill M. Peterson
Assistant Secretary

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53 17 CFR 200.30-3(a)(12).