



## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-84787; File No. SR-C2-2018-024]

Self-Regulatory Organizations; Cboe C2 Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Amending Provisions Related to its Risk Monitor Mechanism

December 11, 2018

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on November 30, 2018, Cboe C2 Exchange, Inc. (the “Exchange” or “C2”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Exchange filed the proposal as a “non-controversial” proposed rule change pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder.<sup>4</sup> 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 C2 Exchange, Inc. (the “Exchange” or “C2”) proposes to amend its provision related to its Risk Monitor Mechanism. The text of the proposed rule change is provided in Exhibit 5.

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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> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

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

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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

#### **1. Purpose**

The Exchange proposes to amend Rule 6.14 which governs, among other things, the Risk Monitor Mechanism.

#### **Background**

By way of background, the Risk Monitor Mechanism provides Users<sup>5</sup> with the ability to manage their order and execution risk. Each User may establish limits for various parameters in the Exchange's counting program. The system counts each of the following within a class ("class limit") and across all classes for an EFID<sup>6</sup> ("firm limit")

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<sup>5</sup> The term "User" means any Trading Permit Holder or Sponsored User who is authorized to obtain access to the System pursuant to Rule 6.8. As discussed below, the Exchange is proposing to replace references to "User" in Rule 6.14(c)(5) with "TPH".

<sup>6</sup> The term "EFID" means an Executing Firm ID. The Exchange assigns an EFID to a Trading Permit Holder, which the System uses to identify the Trading Permit Holder and clearing number for the execution of orders and quotes submitted to

over a User-established time period (“interval”) on a rolling basis up to five minutes (except as set forth in Rule 6.14(c)(5)(A)(iv)) and on an absolute basis for a trading day (“absolute limits”): (i) number of contracts executed (“volume”); (ii) notional value of executions (“notional”); (iii) number of executions (“count”); and (iv) number of contracts executed as a percentage of number of contracts outstanding within an Exchange-designated time period or during the trading day, as applicable (“percentage”)<sup>7</sup> (collectively, “risk parameters”). Additionally, when the system determines a risk parameter exceeds a User’s class limit within the interval or the absolute limit for the class, the Risk Monitor Mechanism cancels or rejects such User’s orders or quotes in all series of the class and cancels or rejects any additional orders or quotes from the User in the class until the counting program resets. Similarly, when the system determines a risk parameter exceeds a User’s firm limit within the interval or the absolute limit for the firm, the Risk Monitor Mechanism cancels or rejects such User’s orders or quotes in all classes and cancels or rejects any additional orders or quotes from the User in all classes until the counting program resets.

#### Proposed Rule Change

The Exchange proposes to amend Rule 6.14 to (i) make clarifying and miscellaneous non-substantive changes, (ii) provide the ability for Users [sic] to establish limits for a group of EFIDs, and (iii) adopt a new risk parameter.

#### Clarifying and Miscellaneous Changes

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the System with that EFID. See C2 Rule 6.8(b).

<sup>7</sup> The system determines the percentage by calculating the percentage of a TPH’s [sic] outstanding contracts that executed on each side of the market during the time period or trading day, as applicable, and then summing the series percentages on each side in the underlying [sic].

First, the Exchange proposes to eliminate the term “User” in Rule 6.14(c)(5) and replace it with the term “TPH” (which stands for Trading Permit Holder).<sup>8</sup> The Exchange notes that the definition of User is broader than TPH, as it specifically captures Sponsored Users. The Exchange believes “TPH” is the more appropriate term to use with respect to the Risk Monitor Mechanism as the rule describes how the functionality works with respect to TPHs, and not necessarily Sponsored Users. The Exchange notes that it currently does not have any Sponsored Users, and to the extent it expects to have any in the future, it will revise the rule as needed to incorporate how the Risk Monitor Mechanism would function with respect to Sponsored Participants. The Exchange notes that “User” will be referred to herein as “TPH”.

Next, the Exchange proposes to eliminate the term “class” and replace it with “underlying”. Specifically, the Exchange notes that the Risk Monitor Mechanism is configured to count the risk parameters across underlying securities or indexes. As an example, any option related to Apple (AAPL), would be considered to have the same underlying. Accordingly, if a corporate action resulted in AAPL1, AAPL and APPL1 one [sic] would be considered to share the same underlying symbol AAPL. Only a single symbol-level rule for underlying AAPL would be configurable by the Risk Monitor Mechanism. The Exchange notes that the term “underlying” is also utilized in the Exchange’s technical specification documents. The Exchange therefore believes underlying is a more accurate term to use.

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<sup>8</sup> See Exchange Rule 1.1 (“Trading Permit Holder” or “TPH”). The term “Trading Permit Holder” or “TPH” mean an Exchange-recognized holder of a Trading Permit. A Trading Permit Holder is deemed a “member” under the Exchange Act.

The Exchange also proposes to eliminate the requirement that the “interval” time periods be on a rolling basis up to five minutes. The Exchange notes that its system is not configured to limit intervals to 5 minutes and as such believes the proposal to eliminate the language will alleviate confusion and more accurately reflect current functionality.

The Exchange also proposes to clarify and codify what were to occur in the event a TPH does not reactivate its ability to send quotes or orders after its configured risk parameter limits have been reached. Currently, subparagraph (c)(5)(D) of Rule 6.14 governs how the counting program is reset. In the event an underlying limit, EFID limit or EFID Group limit (as proposed), is exceeded, the rules provide that the System will not accept new orders or quotes from that TPH (in a underlying, from an EFID, or EFID Group, as applicable) until the TPH instructs the System or Exchange, as applicable, to reset the counting program. The Exchange proposes to add new subparagraph (c)(5)(D)(v) to explicitly provide that if the Exchange cancels all of a TPH’s quotes and orders resting in the Book, and the TPH does not reactivate its ability to send quotes or orders, the block will be in effect only for the trading day that the TPH reached its underlying, EFID and/or EFID Group limit. The Exchange notes this is not a substantive change, but rather current practice, and that its affiliated Exchange, Cboe Options, includes similar language in its rules.<sup>9</sup> The Exchange believes adding this provision to the rules provides further transparency in its rules and reduces potential confusion as to what would happen in the situation where a TPH fails to reset the counting program.

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<sup>9</sup> See Cboe Options Rule 8.18.

The Exchange also proposes to add language regarding resets from its affiliated Exchanges' rules governing their Risk Monitor Mechanism functionality, which is substantively the same as the Risk Monitor Mechanism functionality on C2. Particularly, Cboe EDGX and Cboe BZX Rule 21.16(d) currently provides that the System will reset the counting period for absolute limits when a TPH refreshes its risk limit thresholds and the System will reset the counting program and commence a new interval time period when (i) a previous interval time period has expired and a transaction occurs in any series of a underlying [sic] or (ii) a TPH refreshes its risk limit thresholds prior to the expiration of the interval time period. The Exchange proposes to add this language under subparagraph (D)(vi) of C2 Rule 6.14(c)(5) ("Counting Program Reset"), which provision would govern "other resets" (i.e., resets that are not a result from a limit being reached). The Exchange believes adding this provision to C2's rules provides transparency in the rules that TPH's may refresh their limits for both absolute and interval time periods (which results in a "reset of the counting program") and also clarifies that the interval time periods are reset after the prior interval time period ended and a transaction in a series of a underlying occurred. The Exchange notes this is not a substantive change, but rather current practice. The Exchange believes adding this provision to the rules provides further transparency in its rules and reduces potential confusion as to whether a TPH can refresh its limits and when interval time periods commence.

The Exchange also proposes to include language from BZX and EDGX Rule 21.16(e) that provides that a TPH may engage the Risk Monitor Mechanism to cancel resting bids and offers, as well as subsequent orders as set forth in Rule 6.14(c)(7), which

adds transparency in the rules that the Risk Monitor Mechanism may be utilized in this context. The Exchange notes this is not a substantive change, but rather current practice.

The Exchange also proposes other non-substantive clarifying changes. For example, the Exchange proposes to replace references to “firm limit” with “EFID limit”; clarify that resets will occur when limits are reached, instead of “exceeded”; and replace certain references to “User” with “EFID”. The Exchange notes that the proposed changes do not reflect a change in practice, but rather are intended to adopt language the Exchange believes is more accurate and would be less confusing to investors.

#### EFID Groups

The Exchange next proposes to provide in the rules that in addition to underlying limits and EFID limits, the System will be able to count each of the risk parameters across all underlyings for a group of EFIDs (“EFID Group”)(“EFID Group limit”).<sup>10</sup> Similar to when a underlying limit or EFID limit are reached, when a TPH’s EFID Group(s) limit is reached, the Risk Monitor Mechanism will cancel or reject such TPH’s orders or quotes in all underlyings and cancel or reject any additional orders or quotes from any EFID within the EFID Group(s) in all underlyings until the counting program resets. The System will not accept new orders or quotes from any EFID within an EFID Group after an EFID Group limit is reached until the TPH manually notifies the Trade Desk to reset the counting program for the EFID Group, unless the TPH instructs the Exchange to permit it to reset the counting program by submitting an electronic message to the System. The Exchange believes each TPH is in the best position to determine risk

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<sup>10</sup> An EFID may not belong to more than one EFID Group. The Exchange notes that the Users [sic] determine how many, if any, EFID Groups to establish and determine which EFIDs belong to a particular EFID Group, if any.

settings appropriate for its firm based on its trading activity and business needs and that it may be based on a single EFID or EFID Group(s). The Exchange notes that its affiliate Exchange, Cboe Exchange, Inc. (“Cboe Options”) similarly allows its members to set similar risk parameters at the acronym-level (which is similar to an EFID) or firm level (similar to an EFID Group).<sup>11</sup>

### New Risk Parameter

The Exchange lastly proposes to adopt a new risk parameter. Specifically, under the proposed functionality, a TPH may specify a maximum number of times that the risk parameters (i.e., volume, notional, count and/or percentage) are reached over a specified interval or absolute period (“risk trips”). When a risk trip limit has been reached, the Risk Monitor Mechanism will cancel or reject a TPH’s orders or quotes pursuant to subparagraph (c)(5)(B) of Rule 6.14. The Exchange notes that a similar risk parameter (i.e., a parameter based on the number of risk “incidents” that occur over a specified time) is available on its affiliate Exchange, Cboe Options.<sup>12</sup> The Exchange believes the proposed changes to its Risk Monitor Mechanism rule sufficiently allows TPHs to adjust and adopt parameter inputs in accordance with their business models and risk management needs.

## 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

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<sup>11</sup> See Cboe Options Rule 8.18.

<sup>12</sup> See Cboe Options Rule 8.18, which provides that a Hybrid Market Maker or a TPH Organization may specify a maximum number of Quote Risk Monitor Mechanism (“QRM”) QRM Incidents on an Exchange-wide basis.

the Exchange and, in particular, the requirements of Section 6(b) of the Act.<sup>13</sup> Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>14</sup> requirements that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. Additionally, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>15</sup> requirement that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

First, the Exchange believes its changes to codify existing functionality alleviates potential confusion, provides transparency in the rules and makes the rules easier to read. For example, the proposal to remove the reference to the requirement that the interval time periods be on a rolling basis up to five minutes alleviates confusion as the system is in fact not configured to have a five minute limit. Providing language regarding (i) a TPH's failure to reset or initiate a reset of the counting program, (ii) other resets due to a TPH's refresh of its limits or a new interval time period commencing and (iii) the use of the Risk Monitor Mechanism with respect to C2 Rule 6.14(c)(7), provides transparency in the rules as to what occurs in those situations, harmonizes rule language with that of the Exchange's affiliated Exchanges, and reduces potential confusion. The alleviation of

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<sup>13</sup> 15 U.S.C. 78f(b).

<sup>14</sup> 15 U.S.C. 78f(b)(5).

<sup>15</sup> Id.

confusion removes impediments to, and perfects the mechanism of, a free and open market and a national market system, and, in general, protects investors and the public interest. Similarly, the Exchange believes using the term “underlying” instead of “class” and “TPH” instead of “User” alleviates potential confusion as the proposed terms more accurately reflect how the Risk Monitor Mechanism operates.

The Exchange believes providing TPHs the ability to configure certain risk parameters across underlyings for an EFID Group is also appropriate because it permits a TPH to protect itself from inadvertent exposure to excessive risk on an additional level (i.e., on an EFID group-level, not just underlying- or EFID-level). Reducing such risk will enable TPHs to enter quotes and orders with protection against inadvertent exposure to excessive risk, which in turn will benefit investors through increased liquidity for the execution of their orders. Such increased liquidity benefits investors because they may receive better prices and because it may lower volatility in the options market. The Exchange also believes each TPH is in the best position to determine risk settings appropriate for its firm based on its trading activity and business needs and that that may be based on an EFID Group(s). Additionally, as discussed above, Cboe Options similarly allows its TPHs to set risk parameters at the acronym-level (which is similar to an EFID) or firm-level (similar to an EFID Group).<sup>16</sup>

Lastly, the Exchange believes the proposal to adopt the new risk parameter based on number of times a risk parameter or group of risk parameters are reached will provide TPHs with an additional tool for managing risks. Furthermore, as noted above, the

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<sup>16</sup> See Cboe Options Rule 8.18.

Exchange's affiliated exchange offers similar functionality.<sup>17</sup> Overall, the proposed rule change provides TPHs more protections that reduce the risks from potential system errors and market events. As a result, the proposed changes, including the new risk parameter for the Risk Monitor Mechanism, have the potential to promote just and equitable principles of trade. Additionally, the proposed changes apply to all TPHs.

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. Rather, the Exchange believes that the proposed changes with respect to its Risk Monitor Mechanism help promote fair and orderly markets and provide clarity and transparency the Rule. For example, the proposed rule change adds an additional risk control parameter and flexibility to help further prevent potentially erroneous executions, which benefits all market participants. The proposed changes apply uniformly to all TPHs and the Exchange notes that the proposed changes apply to all quotes and orders in the same manner. Additionally, the Exchange does not believe that the proposed rule change will impose any burden on intermarket competition that is not necessary or appropriate in furtherance of the purposes of the Act because the proposed enhancements apply only to trading on the Exchange. Additionally, the Exchange notes that it is voluntary for the TPHs to determine whether to make use of the new enhancements of the Risk Monitor Mechanism. To the extent that the proposed changes may make the Exchange a more attractive trading venue for market participants on other exchanges, such market participants may elect to become Exchange market participants.

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<sup>17</sup> See Cboe Options Rule 8.18.

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

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

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>18</sup> and Rule 19b-4(f)(6) thereunder.<sup>19</sup>

A proposed rule change filed pursuant to Rule 19b-4(f)(6) under the Act<sup>20</sup> normally does not become operative for 30 days after the date of its filing. However, Rule 19b-4(f)(6)(iii)<sup>21</sup> permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has asked the Commission to waive the 30-day operative delay to provide TPHs with additional tools and greater flexibility for managing their potential risk as soon as possible. Accordingly, the Commission believes that waiver of the 30-day operative delay is consistent with the protection of investors and the public interest. Therefore, the

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<sup>18</sup> 15 U.S.C. 78s(b)(3)(A).

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

<sup>20</sup> 17 CFR 240.19b-4(f)(6).

<sup>21</sup> 17 CFR 240.19b-4(f)(6)(iii).

Commission hereby waives the operative delay and designates the proposal as operative upon filing.<sup>22</sup>

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

#### IV. Solicitation of Comments

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

##### 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-C2-2018-024 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.

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<sup>22</sup> For purposes only of waiving the 30-day operative delay, the Commission also has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

All submissions should refer to File Number SR-C2-2018-024. 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 such 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-C2-2018-024, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>23</sup>

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<sup>23</sup> 17 CFR 200.30-3(a)(12).

Eduardo A. Aleman,  
Deputy Secretary.

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