



## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-88263; File No. SR-CboeBZX-2020-006]

### **Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Notice of Filing of a Proposed Rule Change Relating to Providing Members Certain Optional Risk Settings Under Proposed Interpretation and Policy .03 of Rule 11.13**

February 21, 2020

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 February 12, 2020, Cboe BZX Exchange, Inc. (the “Exchange” or “BZX”) 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 BZX Exchange, Inc.(the “Exchange” or “BZX”) is filing with the Securities and Exchange Commission (the “Commission”) a proposal to provide Members certain optional risk settings under proposed Interpretation and Policy .03 of Rule 11.13.

The text of the proposed rule change is also available on the Exchange’s website ([http://markets.cboe.com/us/equities/regulation/rule\\_filings/bzx/](http://markets.cboe.com/us/equities/regulation/rule_filings/bzx/)), at the Exchange’s Office of the Secretary, and at the Commission’s Public Reference Room.

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

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

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 purpose of the proposed rule change is to provide Members<sup>3</sup> the option to utilize certain risk settings under proposed Interpretation and Policy .03 of Rule 11.13. In order to help Members manage their risk, the Exchange proposes to offer optional risk settings that would authorize the Exchange to take automated action if a designated limit for a Member is breached. Such risk settings would provide Members with enhanced abilities to manage their risk with respect to orders on the Exchange. Paragraph (a) of proposed Interpretation and Policy .03 of Rule 11.13 sets forth the specific risk controls the Exchange proposes to offer. Specifically, the Exchange proposes to offer two credit risk settings as follows:

- The “Gross Credit Risk Limit”, which refers to a pre-established maximum daily dollar amount for purchases and sales across all symbols, where both purchases and sales are counted as positive values. For purposes of calculating the Gross Credit Risk Limit, only executed orders are included; and

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<sup>3</sup> See Exchange Rule 1.5(n).

- The “Net Credit Risk Limit” , which refers to a pre-established maximum daily dollar amount for purchases and sales across all symbols, where purchases are counted as positive values and sales are counted as negative values. For purposes of calculating the Net Credit Risk Limit, only executed orders are included.

The Gross Credit and Net Credit risk settings are similar to credit controls measuring both gross and net exposure provided for in paragraph (h) of Interpretation and Policy .01 of Rule 11.13, but with certain notable differences. Importantly, the proposed risk settings would be applied at a Market Participant Identifier (“MPID”) level, while the controls noted in paragraph (h) of Interpretation and Policy .01 are applied at the logical port level.<sup>4</sup> Therefore, the proposed risk management functionality would allow a Member to manage its risk more comprehensively, instead of relying on the more limited port level functionality offered today. Further, the proposed risk settings would be based on a notional execution value, while the controls noted in paragraph (h) of Interpretation and Policy .03 are applied based on a combination of outstanding orders on the Exchange’s book and notional execution value. The Exchange notes that the current gross and net notional controls noted in paragraph (h) of Interpretation and Policy .03 will continue to be available in addition to the proposed risk settings.

Paragraph (c) of proposed Interpretation and Policy .03 of Rule 11.13 provides that a Member that does not self-clear may allocate and revoke<sup>5</sup> the responsibility of establishing and

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<sup>4</sup> A logical port represents a port established by the Exchange within the Exchange’s System for trading and billing purposes. Each logical port established is specific to a Member or non-Member and grants that Member or non-Member the ability to accomplish a specific function, such as order entry, order cancellation, or data receipt.

<sup>5</sup> As discussed below, if a Member revokes the responsibility of establishing and adjusting the risk settings identified in proposed paragraph (a), the settings applied by the Member would be applicable.

adjusting the risk settings identified in proposed paragraph (a) to a Clearing Member<sup>6</sup> that clears transactions on behalf of the Member, if designated in a manner prescribed by the Exchange.

By way of background, Exchange Rule 11.15(a) requires that all transactions passing through the facilities of the Exchange shall be cleared and settled through a Qualified Clearing Agency using a continuous net settlement system.<sup>7</sup> This requirement may be satisfied by direct participation, use of direct clearing services, or by entry into a corresponding clearing arrangement with another Member that clears through a Qualified Clearing Agency (i.e., a Clearing Member). If a Member clears transactions through another Member that is a Clearing Member, such Clearing Member shall affirm to the Exchange in writing, through letter of authorization, letter of guarantee or other agreement acceptable to the Exchange, its agreement to assume responsibility for clearing and settling any and all trades executed by the Member designating it as its clearing firm.<sup>8</sup> Thus, while not all Members are Clearing Members, all Members are required to either clear their own transactions or to have in place a relationship with a Clearing Member that has agreed to clear transactions on their behalf in order to conduct business on the Exchange. Therefore, the Clearing Member that guarantees the Member's

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<sup>6</sup> The term "Clearing Member" refers to a Member that is a member of a Qualified Clearing Agency and clears transactions on behalf of another Member. See Exchange Rule 11.15(a).

<sup>7</sup> The term "Qualified Clearing Agency" means a clearing agency registered with the Commission pursuant to Section 17A of the Act that is deemed qualified by the Exchange. See Exchange Rule 1.5(u). The rules of any such clearing agency shall govern with the respect to the clearance and settlement of any transactions executed by the Member on the Exchange.

<sup>8</sup> A Member can designate one Clearing Member per Market Participant Identifier ("MPID") associated with the Member.

transactions on the Exchange has a financial interest in the risk settings utilized within the System<sup>9</sup> by the Member.

Paragraph (c) is proposed by the Exchange in order to offer Clearing Members an opportunity to manage their risk of clearing on behalf of other Members, if authorized to do so by the Member trading on the Exchange. Specifically, the Exchange believes such functionality would help Clearing Members to better monitor and manage the potential risks that they assume when clearing for Members of the Exchange. A Member may allocate or revoke the responsibility of establishing and adjusting the risk settings identified in proposed paragraph (a) to its Clearing Member via the risk management tool available on the web portal at any time. By allocating such responsibility, a Member would thereby cede all control and ability to establish and adjust such risk settings to its Clearing Member unless and until such responsibility is revoked by the Member, as discussed in further detail below. Because the Member is responsible for its own trading activity, the Exchange will not provide a Clearing Member authorization to establish and adjust risk settings on behalf of a Member without first receiving consent from the Member. The Exchange would consider a Member to have provided such consent if it allocates the responsibility to establish and adjust risk settings to its Clearing Member via the risk management tool available on the web portal. By allocating such responsibilities to its Clearing Member, the Member consents to the Exchange taking action, as set forth in proposed paragraph (d) of Interpretation and Policy .03, with respect to the Member's trading activity. Specifically, if the risk setting(s) established by the Clearing Member are breached, the Member consents that

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<sup>9</sup> System is defined as “the electronic communications and trading facility designated by the Board through which securities orders of Members are consolidated for ranking, execution and, when applicable, routing away.” See Exchange Rule 1.5(aa).

the Exchange will automatically block new orders submitted and cancel open orders<sup>10</sup> until such time that the applicable risk setting is adjusted to a higher limit by the Clearing Member. A Member may also revoke responsibility allocated to its Clearing Member pursuant to this paragraph at any time via the risk management tool available on the web portal.

Paragraph (b) of proposed Interpretation and Policy .03 of Rule 11.13 provides that either a Member or its Clearing Member, if allocated such responsibility pursuant to paragraph (c) of the proposed Interpretation and Policy, may establish and adjust limits for the risk settings provided in proposed paragraph (a) of Interpretation and Policy .03. A Member or Clearing Member may establish and adjust limits for the risk settings through the Exchange's risk management tool available on the web portal. The risk management web portal page will also provide a view of all applicable limits for each Member, which will be made available to the Member and its Clearing Member, as discussed in further detail below.

Proposed paragraph (d) of Interpretation and Policy .03 of Rule 11.13 would provide optional alerts to signal when a Member is approaching its designated limit. If enabled, the alerts would generate when the Member breaches certain percentage thresholds of its designated risk limit, as determined by the Exchange. Based on current industry standards, the Exchange anticipates initially setting these thresholds at fifty, seventy, or ninety percent of the designated risk limit. Both the Member and Clearing Member<sup>11</sup> would have the option to enable the alerts via the risk management tool on the web portal and designate email recipients of the

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<sup>10</sup> As discussed in further detail below, in the event of a risk setting breach certain orders entered for participation in an auction will not be canceled by the Exchange after the applicable cut-off period.

<sup>11</sup> A Clearing Member would have the ability to enable alerts regardless of whether it was allocated responsibilities pursuant to proposed paragraph (c).

notification.<sup>12</sup> The proposed alert system is meant to warn a Member and Clearing Member of the Member's trading activity, and will have no impact on the Member's order and trade activity if a warning percentage is breached. Proposed paragraph (e) of Interpretation and Policy .03 of Rule 11.13 would authorize the Exchange to automatically block new orders submitted and cancel all open orders in the event that a risk setting is breached.<sup>13</sup> The Exchange will continue to block new orders submitted until the Member or Clearing Member, if allocated such responsibility pursuant to paragraph (c) of proposed Interpretation and Policy .03, adjusts the risk settings to a higher threshold. The proposed functionality is designed to assist Members and Clearing Members in the management of, and risk control over, their credit risk. Further, the proposed functionality would allow the Member to seamlessly avoid unintended executions that exceed their stated risk tolerance.

The Exchange does not guarantee that the proposed risk settings described in proposed Interpretation and Policy .03, are sufficiently comprehensive to meet all of a Member's risk management needs. Pursuant to Rule 15c3-5 under the Act,<sup>14</sup> a broker-dealer with market access must perform appropriate due diligence to assure that controls are reasonably designed to be

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<sup>12</sup> The Member and Clearing Member may input any email address for which an alert will be sent via the risk management tool on the web portal.

<sup>13</sup> Orders entered for participation in the Opening or Closing Auction cannot be canceled or modified after the applicable "cut-off" time, but will be marked for cancellation. See Exchange Rules 11.23(b)(1)(B) and 11.23(c)(1)(B). Therefore, if a risk setting breach occurs after the applicable cut-off time for an Opening or Closing Auction, the auction orders will not be canceled by the Exchange. Similarly, orders entered for participation in the Cboe Market Close ("CMC") will be matched for execution at the applicable cut-off time, and cannot be canceled or modified after the cut-off time. See Exchange Rule 11.28(a) and (b). Therefore, if a risk setting breach occurs after the CMC cut-off time, the CMC auction orders will not be canceled by the Exchange.

<sup>14</sup> 17 CFR § 240.15c3-5.

effective, and otherwise consistent with the rule.<sup>15</sup> Use of the Exchange's risk settings included in proposed Interpretation and Policy .03 will not automatically constitute compliance with Exchange or federal rules and responsibility for compliance with all Exchange and SEC rules remains with the Member.

Additionally, as the Exchange currently has the authority to share any of a Member's risk settings specified in Interpretation and Policy .01 of Rule 11.13 under Exchange Rule 11.15(f) with the Clearing Member that clears transactions on behalf of the Member, the Exchange also seeks such authority as it pertains to risk settings specified in proposed Interpretation and Policy .03. Existing Rule 11.15(f) provides the Exchange with authority to directly provide Clearing Members, that clear transactions on behalf of a Member, to share any of the Member's risk settings set forth under Interpretation and Policy .01 to Rule 11.13.<sup>16</sup> The purpose of such a provision under Rule 11.15(f) was implemented in order to reduce the administrative burden on participants on the Exchange, including both Clearing Members and Members, and to ensure that Clearing Members receive information that is up to date and conforms to the settings active in the System. Further, the provision was implemented because the Exchange believed such functionality would help Clearing Members to better monitor and manage the potential risks that they assume when clearing for Members of the Exchange. Now, the Exchange also proposes to amend paragraph (f) of Exchange Rule 11.15 to authorize the Exchange to share any of a

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<sup>15</sup> See Division of Trading and Markets, Responses to Frequently Asked Questions Concerning Risk Management Controls for Brokers or Dealers with Market Access, available at <https://www.sec.gov/divisions/marketreg/faq-15c-5-risk-management-controls-bd.htm>.

<sup>16</sup> By using the optional risk settings provided in Interpretation and Policy .01, a Member opts-in to the Exchange sharing its risk settings with its Clearing Member. Any Member that does not wish to share such risk settings with its Clearing Member can avoid sharing such settings by becoming a Clearing Member. See Securities Exchange Act Release No. 80611 (May 5, 2017) 82 FR 22045 (May 11, 2017) (SR-BatsBZX-2017-24).

Member's risk settings specified in proposed Interpretation and Policy .03 to Rule 11.13 with the Clearing Member that clears transactions on behalf of the Member. The Exchange notes that the use by a Member of the risk settings offered by the Exchange is optional. By using these proposed optional risk settings, a Member therefore also opts-in to the Exchange sharing its designated risk settings with its Clearing Member. The Exchange believes that its proposal to offer additional risk settings will allow Members to better manage their credit risk. Further, by allowing Members to allocate the responsibility for establishing and adjusting such risk settings to its Clearing Member, the Exchange believes Clearing Members may reduce potential risks that they assume when clearing for Members of the Exchange. The Exchange also believes that its proposal to share a Member's risk settings set forth under proposed Interpretation and Policy .03 to Rule 11.13 directly with Clearing Members reduces the administrative burden on participants on the Exchange, including both Clearing Members and Members, and ensures that Clearing Members are receiving information that is up to date and conforms to the settings active in the System.

## 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.<sup>17</sup> Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>18</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

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<sup>17</sup> 15 U.S.C. 78f(b).

<sup>18</sup> 15 U.S.C. 78f(b)(5).

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.

Specifically, the Exchange believes the proposed amendment will remove impediments to and perfect the mechanism of a free and open market and a national market system because it provides additional functionality for a Member to manage its credit risk. In addition, the proposed risk settings could provide Clearing Members, who have assumed certain risks of Members, greater control over risk tolerance and exposure on behalf of their correspondent Members, if allocated responsibility pursuant to proposed paragraph (c), while also providing an alert system that would help to ensure that both Members and its Clearing Member are aware of developing issues. As such, the Exchange believes that the proposed risk settings would provide a means to address potentially market-impacting events, helping to ensure the proper functioning of the market.

In addition, the Exchange believes that the proposed rule change is designed to protect investors and the public interest because the proposed functionality is a form of risk mitigation that will aid Members and Clearing Members in minimizing their financial exposure and reduce the potential for disruptive, market-wide events. In turn, the introduction of such risk management functionality could enhance the integrity of trading on the securities markets and help to assure the stability of the financial system.

Further, the Exchange believes that the proposed rule will foster cooperation and coordination with persons facilitating transactions in securities because the Exchange will

provide alerts when a Member's trading activity reaches certain thresholds, which will be available to both the Member and Clearing Member. As such, the Exchange may help Clearing Members monitor the risk levels of correspondent Members and provide tools for Clearing Members, if allocated such responsibility, to take action.

The proposal will permit Clearing Members who have a financial interest in the risk settings of Members to better monitor and manage the potential risks assumed by Clearing Members, thereby providing Clearing Members with greater control and flexibility over setting their own risk tolerance and exposure. To the extent a Clearing Member might reasonably require a Member to provide access to its risk settings as a prerequisite to continuing to clear trades on the Member's behalf, the Exchange's proposal to share those risk settings directly reduces the administrative burden on participants on the Exchange, including both Clearing Members and Members. Moreover, providing Clearing Members with the ability to see the risk settings established for Members for which they clear will foster efficiencies in the market and remove impediments to and perfect the mechanism of a free and open market and a national market system. The proposal also ensures that Clearing Members are receiving information that is up to date and conforms to the settings active in the System. The Exchange believes that the proposal is consistent with the Act, particularly Section 6(b)(5),<sup>19</sup> because it will foster cooperation and coordination with persons engaged in facilitating transactions in securities and more generally, will protect investors and the public interest, by allowing Clearing Members to better monitor their risk exposure and by fostering efficiencies in the market and removing

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<sup>19</sup> 15 U.S.C. 78f(b)(5).

impediments to and perfect the mechanism of a free and open market and a national market system.

Finally, the Exchange believes that the proposed rule change does not unfairly discriminate among the Exchange's Members because use of the risk settings are optional and are not a prerequisite for participation on the Exchange. The proposed risk settings are completely voluntary and, as they relate solely to optional risk management functionality, no Member is required or under any regulatory obligation to utilize them.

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. In fact, the Exchange believes that the proposal may have a positive effect on competition because it would allow the Exchange to offer risk management functionality that is comparable to functionality proposed to be offered by other national securities exchanges.<sup>20</sup> Further, by providing Members and their Clearing Members additional means to monitor and control risk, the proposed rule may increase confidence in the proper functioning of the markets and contribute to additional competition among trading venues and broker-dealers. Rather than impede competition, the proposal is designed to facilitate more robust risk management by Members and Clearing Members, which, in turn, could enhance the integrity of trading on the securities markets and help to assure the stability of the financial system.

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.

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<sup>20</sup> See Securities Exchange Act Release No. 87715 (December 11, 2019) 84 FR 68995 (December 17, 2019) (SR-NYSE-2019-68).

II. 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](mailto:rule-comments@sec.gov). Please include File Number SR-CboeBZX-2020-006 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-CboeBZX-2020-006. 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-CboeBZX-2020-006 and should be submitted on or before **[INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>21</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

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<sup>21</sup> 17 CFR 200.30-3(a)(12).

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