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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-90173; File No. SR-CBOE-2020-072]

### **Self-Regulatory Organizations; Cboe Exchange, Inc.; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to Establish a Priority Queue for Auction Response Messages**

October 14, 2020.

#### I. Introduction

On July 30, 2020, Cboe Exchange, Inc. (the “Exchange” or “Cboe Options”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to establish a priority queue for auction response messages. The proposed rule change was published for comment in the Federal Register on August 18, 2020.<sup>3</sup> On September 25, 2020, pursuant to Section 19(b)(2) of the Act,<sup>4</sup> the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.<sup>5</sup> The Exchange filed

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

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

<sup>3</sup> See Securities Exchange Act Release No. 89528 (August 12, 2020), 85 FR 50855 (“Notice”).

<sup>4</sup> 15 U.S.C. 78s(b)(2).

<sup>5</sup> See Securities Exchange Act Release No. 90007 (September 25, 2020), 85 FR 62004 (October 1, 2020). The Commission designated November 16, 2020, as the date by which the Commission shall approve or disapprove, or institute proceedings to determine whether to disapprove, the proposed rule change.

Amendment No. 1 to the proposal on October 9, 2020.<sup>6</sup> The Commission received no comments regarding the proposal. The Commission is publishing this notice to solicit comment on Amendment No. 1 and is approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

## II. Description of the Proposed Rule Change, as Modified by Amendment No. 1

As described more fully in the Notice,<sup>7</sup> the Exchange currently offers several auction mechanisms that provide price improvement opportunities for eligible orders.<sup>8</sup> Users<sup>9</sup> may submit responses to an auction during an auction response period determined by the Exchange.<sup>10</sup> Trading Permit Holders (“TPHs”) submit auction responses through logical ports within the Exchange’s trading system that deliver and/or receive trading messages, including orders, cancels, and auction responses.<sup>11</sup> Currently, the System<sup>12</sup> processes all messages through a

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<sup>6</sup> In Amendment No. 1, the Exchange revised the proposal to: (1) state that the Exchange does not intend to assess a fee for use of the proposed priority queue; (2) indicate that messages to modify or cancel an auction response would not be processed through the proposed priority queue; (3) provide updated information regarding the number of auction responses that did not reach the auction to which they were submitted in time to participate in the auction; (4) clarify the current duration of the auction response period; (5) state that all market participants are permitted to submit auction responses to any of the Exchange’s auction mechanisms, and that all auction responses, to any auction mechanism, from any user, would be processed through the proposed priority queue; and (6) provide additional analysis to support the proposal. Amendment No. 1 will be available on the Commission’s website.

<sup>7</sup> See note 3, *supra*.

<sup>8</sup> These auction mechanisms include the Complex Order Auction (“COA”) (Cboe Rule 5.33(d)); the Step Up Mechanism (“SUM”) (Cboe Rule 5.35); the Automated Improvement Mechanism (“AIM”) (Cboe Rule 5.37); the Complex AIM (“C-AIM”) (Cboe Rule 5.38); the Solicitation Auction Mechanism (“SAM”) (Cboe Rule 5.39); the Complex SAM (“C-SAM”) (Cboe Rule 5.40); the FLEX Auction Process (Cboe Rule 5.72(c)); the FLEX AIM (Cboe Rule 5.73); and the FLEX SAM (Cboe Rule 5.74). See Notice, 85 FR at 50855.

<sup>9</sup> A User is a Trading Permit Holder or Sponsored User who is authorized to obtain access to the System pursuant to Cboe Rule 5.5. See Cboe Rule 1.1.

single queue.<sup>13</sup> Under certain circumstances, including when there is a deep queue of other message traffic, the auction response period may end before the System is able to process queued auction response messages, resulting in the auctioned order missing potential price improvement from the queued auction response(s) and the auction response(s) missing an execution opportunity.<sup>14</sup>

To reduce the latency associated with auction responses, the Exchange proposes to amend Cboe Rule 5.25 to establish a priority queue for the processing of auction response messages.<sup>15</sup> All other messages, including new orders and quotes, cancel messages, and modify messages, will be processed through a general queue.<sup>16</sup> The System will process a certain number of messages, as determined by the Exchange, from each queue on an alternating basis, and will process the messages in each queue in time priority.<sup>17</sup> The Exchange believes that the priority queue will provide for more timely processing of auction responses and will increase the likelihood that an auction response is able to participate in the auction to which it is submitted, thereby increasing execution opportunities for auction responses and enhancing the potential for

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<sup>10</sup> See Notice, 85 FR at 50855-6.

<sup>11</sup> See id. at 50856.

<sup>12</sup> The System is the Exchange's hybrid trading platform that integrates electronic and open outcry trading of option contracts on the Exchange, and includes any connectivity to the foregoing trading platform that is administered by or on behalf of the Exchange, such as a communications hub. See Cboe Rule 1.1.

<sup>13</sup> See Notice, 85 FR at 50856.

<sup>14</sup> See id.

<sup>15</sup> Modifications or cancellations of auction responses will not be processed through the Priority Queue. See Amendment No. 1.

<sup>16</sup> See proposed Cboe Rule 5.25(c) and Notice, 85 FR at 50856.

<sup>17</sup> See proposed Cboe Rule 5.25(c).

price improvement for orders submitted to the Exchange's auction mechanisms.<sup>18</sup> The Exchange notes that every market participant may submit a response message to any of the Exchange's auction mechanisms and that all auction response messages would be processed through the proposed priority queue.<sup>19</sup>

The Exchange states that from March 30 - April 3, 2020, approximately 17% of all auction responses and 47% of SPXW auction responses submitted during their auction response periods had no opportunity to execute in their respective auctions.<sup>20</sup> During the period from September 1 - September 21, 2020, approximately 3% of all auction responses, and 8% of auction responses in SPXW, had no opportunity to execute in their respective auctions, notwithstanding being submitted within the auction response period.<sup>21</sup> Although there were fewer missed auction responses during the period from September 1 - September 21, 2020, than during the week of March 30, the Exchange believes that both auction responders and market participants (including customers) whose orders are being auctioned benefit when the number of missed auction responses is as close to zero as possible because an auctioned order may miss an opportunity for price improvement if an auction response message is not processed in time.<sup>22</sup> In addition, the Exchange states that, absent the proposed rule change, the percentage of missed auction responses could increase during periods of increased volatility because of the increased

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<sup>18</sup> See Notice, 85 FR at 50856.

<sup>19</sup> See Amendment No. 1.

<sup>20</sup> See id. Effective March 9, 2020, the Exchange increased the auction response period for COA in classes SPX/SPXW from 100 milliseconds to 1,000 milliseconds. On March 16, 2020, the Exchange activated AIM for classes SPX/SPXW and set the auction response period for classes SPX/SPXW to 1,000 milliseconds. See Amendment No. 1.

<sup>21</sup> The AIM and COA auction response period during this time was set at 1,000 milliseconds for SPX/SPXW. See id.

<sup>22</sup> See id.

message traffic that occurs at such times.<sup>23</sup> The Exchange also believes that the percentage of missed auction responses would likely increase if the Exchange reduced the auction response period back to 100 milliseconds.<sup>24</sup>

The Exchange believes that the proposed priority queue for auction response messages will not disadvantage other orders, including customer orders.<sup>25</sup> The proposal does not modify the Exchange's rules regarding allocations at the conclusion of an auction and, accordingly, priority customer orders in the Book<sup>26</sup> will continue to have first priority at each price level at the conclusion of a paired auction, even when an auction response is processed via a priority queue ahead of a priority customer order processed via the general queue.<sup>27</sup> The Exchange states that the number of messages that would be processed via the proposed priority queue as compared to the general queue is small.<sup>28</sup> The Exchange notes that during the period from March 9 - March

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<sup>23</sup> See id.

<sup>24</sup> The Exchange believes that a shorter auction response period, such as 100 milliseconds, allows the Exchange to provide investors and other TPHs with more timely executions, thereby reducing their market risk. The Exchange notes that TPHs who initiate auction orders in AIM are required to guarantee an execution at the National Best Bid/Offer ("NBBO") or a better price based on market prices prior to the commencement of the auction and are subject to market risk while the order is exposed during the auction response period. The Exchange states that large price changes can occur in one second or less, leaving initiating TPHs vulnerable to trading losses. The Exchange further states that the initiating TPH's willingness to guarantee its customer an execution at the NBBO or a better price is essential to the customer order gaining the opportunity for price improvement. Accordingly, the Exchange believes that an auction time as low as 100 milliseconds would provide investors and other market participants with more timely executions and reduce their market risk. See Amendment No. 1.

<sup>25</sup> See Amendment No. 1.

<sup>26</sup> The Book is the electronic book of simple orders and quotes maintained by the System, which single book is used during both the Regular Trading Hours and Global Trading Hours trading sessions. See Cboe Rule 1.1.

<sup>27</sup> See Notice, 85 FR at 50856.

<sup>28</sup> See id.

13, 2020, auction responses across all of the Exchange's auction mechanisms accounted for approximately 0.02% of the message traffic, while new order/quote messages accounted for approximately 40.3% of the message traffic, modify messages accounted for approximately 47.9% of the message traffic, and cancel messages accounted for approximately 11.7% of the message traffic.<sup>29</sup> The Exchange further notes that only 0.007% of non-auction response messages were related to a customer order.<sup>30</sup> Accordingly, the Exchange believes that it is unlikely that a customer's order would not be posted to the Book in time to receive a priority allocation because the System was processing messages in the priority queue.<sup>31</sup>

### III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, with Section 6(b) of the Act.<sup>32</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>33</sup> which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest, and that the rules of a national securities exchange not be

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<sup>29</sup> See id.

<sup>30</sup> See id.

<sup>31</sup> See Amendment No. 1.

<sup>32</sup> 15 U.S.C. 78f(b). In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>33</sup> 15 U.S.C. 78f(b)(5).

designed to permit unfair discrimination between customers, issuers, brokers or dealers. The Commission believes that the proposed priority queue could help auction responses reach the auction to which they were submitted in time to participate in the auction, potentially enhancing competition in the Exchange's auctions and increasing the likelihood that orders submitted to auctions, including customer orders, will receive price improvement. The Commission notes that all market participants may submit auction responses to any of the Exchange's auction mechanisms and that all auction responses will be processed through the priority queue.<sup>34</sup> In addition, the Exchange's rules governing allocations at the conclusion of an auction remain unchanged and, accordingly, priority customer orders resting in the Book will continue to have first priority at each price level at the conclusion of a paired auction.<sup>35</sup>

#### IV. Solicitation of Comments on Amendment No. 1 to the Proposed Rule Change

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 1 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-CBOE-2020-072 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>34</sup> See Amendment No. 1.

<sup>35</sup> See Notice, 85 FR 50856.

All submissions should refer to File Number SR-CBOE-2020-072. 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-2020-072, and should be submitted on or before **[INSERT DATE 21 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER]**.

V. Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 1

The Commission finds good cause to approve the proposed rule change, as modified by Amendment No. 1 prior to the thirtieth day after the date of publication of notice of the filing of Amendment No. 1 in the Federal Register. Amendment No. 1 does not modify the substance of the proposal or raise new regulatory issues. As described more fully above, Amendment No. 1 clarifies several aspects of the proposal and provides updated data and additional analysis to support the proposal. Among other things, Amendment No. 1 provides further analysis

regarding the potential effect of the proposal on non-auction response message traffic, including customer orders. Amendment No. 1 also states that all market participants are permitted to submit auction responses to any of the Exchange's auction mechanisms and that all auction responses will be processed through the priority queue. Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act,<sup>36</sup> to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>37</sup> that the proposed rule change (SR-CBOE-2020-072), as modified by Amendment No. 1, is approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>38</sup>

**J. Matthew DeLesDernier,**

*Assistant Secretary.*

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<sup>36</sup> 15 U.S.C. 78s(b)(2).

<sup>37</sup> 15 U.S.C. 78s(b)(2).

<sup>38</sup> 17 CFR 200.30-3(a)(12).