OMB APPROVAL
OMB Number: 3235-0045 Estimated average burden hours per response...........38

Required fields are shown with yellow backgrounds and asterisks.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No.* SR - 2020 - * 099
Amendment No. (req. for Amendments *)

Filing by Cboe Exchange, Inc.

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * ☑ Amendment * ☐ Withdrawal ☐

Section 19(b)(2) * ☐ Section 19(b)(3)(A) * ☑ Section 19(b)(3)(B) * ☐

Pilot ☐

Extension of Time Period for Commission Action * ☐

Date Expires *

Rule

☐ 19b-4(f)(1) ☐ 19b-4(f)(4)
☐ 19b-4(f)(2) ☐ 19b-4(f)(5)
☐ 19b-4(f)(3) ☑ 19b-4(f)(6)

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010

Section 806(e)(1) * ☐ Section 806(e)(2) * ☐

Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934

Section 3C(b)(2) * ☐

Exhibit 2 Sent As Paper Document ☐ Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

The Exchange proposes to amend Rule 5.34 in connection with its debit/credit price reasonability check.

Contact Information

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name * Rebecca Last Name * Tenuta
Title * Counsel
E-mail * rtenuta@cboe.com
Telephone * (312) 786-7068 Fax

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date 10/13/2020
By Laura G. Dickman
(Name *)

(Title *)
VP, Associate General Counsel

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

ldickman@cboe.com

Required fields are shown with yellow backgrounds and asterisks.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information * Add Remove View	The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.
Exhibit 1 - Notice of Proposed Rule Change * Add Remove View	The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO] -xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)
Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies * Add Remove View	The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO] -xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)
Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications Add Remove View Exhibit Sent As Paper Document ☐	Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.
Exhibit 3 - Form, Report, or Questionnaire Add Remove View Exhibit Sent As Paper Document ☐	Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.
Exhibit 4 - Marked Copies Add Remove View	The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.
Exhibit 5 - Proposed Rule Text Add Remove View	The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.
Partial Amendment Add Remove View	If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

Item 1. <u>Text of the Proposed Rule Change</u>

(a) Cboe Exchange, Inc. (the "Exchange" or "Cboe Options") proposes to amend Rule 5.34 in connection with its debit/credit price reasonability check. The text of the proposed rule change is provided in Exhibit 5.

(b) Not applicable.

(c) Not applicable.

Item 2. <u>Procedures of the Self-Regulatory Organization</u>

(a) The Exchange's President (or designee) pursuant to delegated authority approved the proposed rule change on September 10, 2020.

(b) Please refer questions and comments on the proposed rule change to Pat Sexton, Executive Vice President, General Counsel, and Corporate Secretary, (312) 786-7467, or Rebecca Tenuta, (312) 786-7068, Cboe Exchange, Inc., 400 South LaSalle, Chicago, Illinois 60605.

Item 3. <u>Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change</u>

(a) <u>Purpose</u>

The Exchange proposed to amend Rule 5.34(b)(3), which provides for its debit/credit price reasonability check. Specifically, the proposed rule change amends Rule 5.34(b)(3)(A) in connection with two-legged strategies that have one A.M.-settled leg and one P.M.-settled leg with the same expiration date.[1] The proposed rule change also codifies the definition of diagonal spreads in Rule 5.34(b)(1)(E), which is already a strategy described in Rule 5.34(b)(3) and handled by the System in connection with the debit/credit

---

[1] The proposed rule change also updates the definition of vertical spread in Rule 5.34(b)(1)(A) and the definition of calendar spread in Rule 5.34(b)(1)(D) in light of the proposed change to Rule 5.34(b)(3)(A).

reasonability check, the codified definition of which was inadvertently omitted in the rule filing that allowed the System to apply the debit./credit reasonability check to diagonal spreads.[2]

Pursuant to the debit/credit price reasonability check, the Exchange cancels or rejects a complex order (or unexecuted portion) that is a limit order for a debit strategy with a net credit price that exceeds a pre-set buffer, a limit order (or unexecuted portion) for a credit strategy with a net debit price that exceeds a pre-set buffer, or a market order (or unexecuted portion) for a credit strategy that would execute at a net debit price that exceeds a pre-set buffer (the pre-set buffers are determined by the Exchange on a class and strategy (i.e., vertical, calendar, butterfly, orders with different expiration dates and exercise prices) basis). The System defines a complex order as a debit (credit) if all pairs and loners are debits (credits).[3] For purposes of the credit/debit price reasonability check, a "pair" is a pair of legs in an order for which both legs are calls or both legs are puts, one leg is a buy and one leg is a sell, and the legs have the same expiration date but different exercise prices (i.e., vertical)[4], the same exercise price but different expiration dates (i.e., calendar)[5], or the exercise price for the call (put) with the farther expiration date is lower (higher) than the

---

2 See Securities Exchange Release No. 88923 (May 21, 2020), 85 FR 32086 (May 28, 2020) (SR-CBOE-2020-046).

3 See Rule 5.34(b)(3)(B)(i) and (ii). The System also determines certain call and put butterfly spreads as debits and credits.

4 See also Rule 5.34(b)(1)(A), which defines a "vertical spread" as a two-legged complex order with one leg to buy a number of calls (puts) and one leg to sell the same number of calls (puts) with the same expiration date but different exercise prices.

5 See also Rule 5.34(b)(1)(D), which defines a "calendar spread" as a two-legged complex order with one leg to buy a number of calls (puts) and one leg to sell the same number of calls (puts) with the same exercise price but different expiration dates.

exercise price for the nearer expiration date (which is a diagonal pair). A “loner” is any leg in an order that the System cannot pair with another leg in the order.

The System determines whether an order is a debit or credit based on general options volatility and pricing principles, which the Exchange understands are used by market participants in their option pricing models. With respect to options with the same underlying:

- if two calls (puts) have the same expiration date, the price of the call (put) with the lower (higher) exercise price is more than the price of the call (put) with the higher (lower) exercise price; and
- if two calls (puts) have the same exercise price, the price of the call (put) with the nearer expiration is less than the price of the call (put) with the farther expiration.

In other words, a call (put) with a lower (higher) exercise price is generally more expensive than a call (put) with a higher (lower) exercise price, because the ability to buy stock at a lower price is more valuable than the ability to buy stock at a higher price, and the ability to sell stock at a higher price is more valuable than the ability to sell stock at a lower price. A call (put) with a farther expiration is generally more expensive than the price of a call (put) with a nearer expiration, because locking in a price further into the future involves more risk for the buyer and seller and thus is more valuable, making an option (call or put) with a farther expiration more expensive than an option with a nearer expiration. Based on the principles described above and pursuant to Rule 5.34(b)(3)(B)(iii), the System pairs calls (puts) under the current debit/credit reasonability check, as follows:

1) The System first pairs legs to the extent possible within each expiration date, pairing one leg with the leg that has the next highest exercise price.

2) The System then pairs legs to the extent possible across expiration dates, pairing one call (put) with the call (put) that has the next nearest expiration date and the same or next lower (higher) exercise price.

3) A pair of calls is a credit (debit) if the exercise price of the buy (sell) leg is higher than the exercise price of the sell (buy) leg (if the pair has the same expiration date) or if the expiration date of the sell (buy) leg is farther than the expiration date of the buy (sell) leg (if the exercise price of the sell (buy) leg is the same as or lower than the exercise price of the buy (sell) leg).

4) A pair of puts is a credit (debit) if the exercise price of the sell (buy) leg is higher than the exercise price of the buy (sell) leg (if the pair has the same expiration date) or if the expiration date of the sell (buy) leg is farther than the expiration date of the buy (sell) leg (if the exercise price of the sell (buy) leg is the same as or higher than the exercise price of the buy (sell) leg).

5) A loner to buy is a debit, and a loner to sell is a credit.

Additionally, the System does not apply the debit/credit price reasonability check to an order for which the System cannot define whether it is a debit or credit.

As indicated above, the debit/credit reasonability check allows the Exchange to determine a pre-set buffer on a class-by-class and strategy basis (i.e., vertical, calendar, butterfly, orders with different expiration dates and exercise prices). This flexibility allows the Exchange to appropriately respond to the different trading characteristics and market conditions that have unique impact across different classes and different strategies. For example, the Exchange understands that in certain market conditions, particularly in volatile conditions, the general pricing principles described above may not apply to certain classes or strategies. It is possible that the leg with the farther expiration may be trading at a discount and thus is worth less than the leg with the nearer term expiration, and thus entering a diagonal or calendar strategy as a debit may be consistent with the then-current market. Specifically, certain classes may exhibit backwardation,[6] which occurs when series with the farther expirations are worth less than series with the nearer term expirations. In such conditions, the Exchange may deem it appropriate to increase the buffer to permit these orders to be accepted for electronic processing. While an order with a diagonal or calendar strategy entered as a debit in normal market conditions may appear erroneous and be appropriately rejected, in volatile market conditions, such an order entered as a debit may be accurately reflecting the market. As such, the flexibility to establish pre-set buffers on a class and strategy basis currently permits the Exchange to provide a calendar or diagonal strategy order entered as a debit with electronic execution opportunities, as applicable, by modifying the buffer of these strategies with legitimate debit prices that are consistent with then-current market conditions. In this way, the System may accept such orders while maintaining the check's protection for classes and strategies whose pricing is not impacted by these market conditions and are not experiencing backwardation.

As stated above, for purposes of the debit/credit reasonability check, the System defines a vertical spread order as a two-legged complex order with one leg to buy a number of calls (puts) and one leg to sell the same number of calls (puts) with the same expiration date but different exercise prices,[7] and a calendar spread order as a two-legged complex

---

6 Specifically, European-settled options (which is a group of classes) may experience backwardation. For example, SPX is a European style option that may be impacted by backwardation in unusual or volatile market conditions. Accordingly, the Exchange regularly sets widened buffers for SPX diagonal pairs.

7 <u>See</u> Rule 5.34(b)(1)(A).

order with one leg to buy a number of calls (puts) and one leg to sell the same number of calls (puts) with the same exercise price but different expiration dates.[8] The Exchange notes that while the expiration date of the legs of a vertical or calendar spread with an A.M.-settled leg and a P.M.-settled leg may be the same, the last trading date of the two legs differs. For example, an S&P 500 Index ("SPX") option/SPX Weekly ("SPXW") vertical spread would contain the same expiration date, yet SPX options are A.M.-settled, thus they stop trading on the Thursday prior to Friday expiration, and SPXW options are P.M.-settled, thus they stop trading at the close on Friday expiration. As a result, the time to expiration of trading for each leg is different, which the Exchange understands is what market participants consider when pricing options with an A.M.-settled/P.M.-settled vertical strategy, similar to the pricing of a diagonal spread, or when pricing options with an A.M.-settled/P.M.-settled calendar strategy — in other words, market participants consider these legs to have different expiration dates. When applying the debit/credit reasonability check, however, the System currently considers a strategy with one P.M.-settled leg and one A.M.-settled leg with the same expiration date and different exercise prices to be a vertical strategy, rather than a diagonal strategy., and it rejects a strategy with one P.M.-settled leg and one A.M.-settled leg with the same expiration date and same exercise prices because it does not recognize this strategy as a calendar strategy. More specifically, the System and the Rules do not currently consider the difference in time between the actual close of trading for the A.M.-settled leg and the actual close of trading the following day for the P.M.-settled leg – it considers only that the legs have the same expiration date. As a result, the System does not determine the credit (debit) net price for vertical or calendar spread orders with a pair(s) of A.M.-

---

8 See Rule 5.34(b)(1)(D).

settled/P.M.-settled legs using the same pricing principles for the debit/credit reasonability check that the Exchange understands market participants use for these strategies, as market participants consider these spreads to have different expiration dates, and thus to be diagonals (rather than verticals) or calendars for pricing purposes. That is, if a sell (buy) leg is P.M.-settled (i.e., is “farther out” in time until trading actually ceases) and is a call (put) with an exercise price that is the same as or lower (higher) than the exercise price of the buy (sell) A.M.-settled leg (thus making the P.M.-settled leg more expensive), the System would not treat this as a diagonal spread, nor recognize it as a calendar spread, pursuant to Rule 5.34(b)(3)(B)(iii)(c) and (d), even though market participants would price these spreads as a diagonal (if the legs have different exercise prices) or calendar (if the legs have the same exercise price) from a pricing perspective.

Specifically, a vertical spread with A.M.-settled/P.M.-settled legs essentially emulates the manner in which a diagonal strategy executes, given that each leg in a diagonal strategy ceases trading at different times (because they have different expiration dates) and diagonal spread legs, like vertical spread legs, also have different exercise prices. Likewise, a spread with A.M.-settled/P.M.-settled legs with the same exercise price essentially emulates the manner in which a calendar spread executes, given that each leg in a calendar strategy ceases trading at different times (because they have different expiration dates). Under the proposal, the debit/credit reasonability check logic and Exchange-determined buffers, where applicable, would apply in the same manner as they do today for calendar and diagonal spreads, as applicable, to spreads with a pair(s) of A.M.-settled/P.M.-settled legs. Therefore, the proposed rule change amends Rule 5.34(b)(3)(A) to provide that, for the purposes of the debit/credit price reasonability check, the System considers a two-legged strategy with one P.M.-settled leg and one A.M.-settled leg with the same expiration date to be a diagonal spread (where both legs have different expiration dates and different exercise prices), rather than a vertical spread, or a calendar spread (where both legs have the same exercise price).[9] As a result, the System will apply to such vertical strategies, which are generally priced using the same principles as diagonal spreads and may be adjusted to reflect backwardation (as described above), the same debit/credit check logic and pre-set buffers that it currently applies to diagonal spreads. In addition, the System will apply to such strategies, which are generally priced using the same principles as calendar spreads, the same debit/credit check logic and pre-set buffers that it currently applies to calendar spreads and not reject such strategies because the legs have the same expiration dates and exercise prices. The Exchange believes the enhancing the debit/credit price reasonability check to consider a spread that contains a pair of A.M.-settled/P.M. settled legs with the same expiration date as a diagonal or calendar, as appropriate, will cause the System to apply more accurate pricing principles to them when determining whether to accept or reject strategies with A.M.-settled/P.M.-settled legs.

Regarding vertical spreads with A.M.-settled/P.M.-settled legs with the same expiration date and different exercise prices,, currently, if the System receives such a vertical spread order, and the exercise price for the sell leg is lower than the exercise price of the buy leg with a debit price, the System will determine this to be a credit and reject it (assuming it is outside of the buffer). However, if the class is experiencing backwardation, the debit price may be appropriate. As discussed above, the Exchange may widen the buffer for such a class in such circumstances for calendars and diagonals to account for the backwardation.

---

9 See supra note 1.

Therefore, if the System receives a spread with A.M.-settled/P.M.-settled legs in a class experiencing backwardation during unusual or volatile market conditions, the System would apply a different buffer to that spread than it would apply to a diagonal spread. While the A.M.-settled/P.M.-settled vertical spread would likely have been priced using the same pricing principles as the diagonal spread, the System would reject the vertical spread order, despite it likely having a legitimate price, while accepting the diagonal order with a similarly legitimate price. Pursuant to the proposed rule change the strategy described above would be handled as a diagonal and will have the opportunity to be accepted and executed. Similarly, the System will recognize a spread with A.M.-settled/P.M.-settled legs with the same expiration date and the same exercise price as a calendar spread and not reject such spread order.

The Exchange notes that it announces any changes to the parameters of the debit/credit reasonability check to market participants by Exchange notice pursuant to Rule 1.5. The Exchange notes too that it will continue to regularly monitor the application of the debit/credit price reasonability check, including the number of orders rejected as a result of the check, as well as continue to monitor orders that may be executed at erroneous prices pursuant to Rule 6.5. The Exchange currently considers all of these factors, as well as market conditions, investor demand, and other relevant factors when determining whether to modify the debit/credit reasonability check buffer or other risk control parameters in order to attempt to create an appropriate balance between protection against executions at potentially erroneous prices and provision of execution opportunities for legitimately priced orders.

In addition to this, the proposed rule change codifies the definition of diagonal spreads in the current spread definitions in Rule 5.34(b)(1). Specifically, proposed Rule

5.34(b)(1)(E) provides that a "diagonal" spread is a two-legged complex order with one leg to buy a number of calls (puts) and one leg to sell the same number of calls (puts) with different expiration dates and different exercise prices. As noted above, diagonal spreads are currently described within Rule 5.34(b) and the System currently applies the debit/credit reasonability check and Exchange-determined buffers to diagonal spreads pursuant to Rule 5.34(b)(3)(A).[10] The Exchange merely inadvertently omitted codifying the definition of diagonal spreads in a previous rule filing that updated Rule 5.34 to allow the System to apply the debit/credit reasonability check to diagonals.[11]

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.[12] Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)[13] 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

---

10 In light of the proposed codified definition, the Exchange updates the current description of a diagonal in Rule 5.34(b)(3)(A) to, instead, refer to "diagonal", as well as adds this reference to the description of a diagonal in Rule 5.34(b)(3)(B)(iii).

11 See supra note 2.

12 15 U.S.C. 78f(b).

13 15 U.S.C. 78f(b)(5).

interest. Additionally, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)[14] 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 perfects the mechanism of a free and open market and national market system by applying the current debit/credit price reasonability check logic for diagonal spreads (which have different expiration dates and thus cease trading on different dates, as well as different exercise prices) to spread orders with A.M.-settled/P.M.-settled legs that have different exercise prices but the same expiration date (and are thus currently defined as verticals) but similarly cease trading on different dates. Additionally, it will allow the System to recognize spreads with A.M.-settled/P.M.-settled legs that have the same exercise price and the same expiration date, but likewise cease trading on different dates, to be calendar spreads (which have different expiration dates and the same exercise price). By considering these particular orders to be diagonals rather than verticals, or to be calendars, the Exchange will apply the same buffers to vertical strategies that have legs that stop trading at different times (i.e., one leg is A.M-settled and one leg is P.M.-settled) as it applies to diagonal strategies (which also have legs that stop trading at different times), and will apply the same buffers to strategies that have legs that stop trading at different times (i.e., one leg is A.M-settled and one leg is P.M.-settled) and the same exercise price as it applies to calendar strategies. This handling of vertical spreads is appropriate in classes in which market conditions may cause the P.M.-settled leg (with the farther time until trading expiration) to trade at a discount and be

---

14 Id.

worth less than the A.M.-settled leg (with the nearer time until trading expiration). By considering a vertical strategy with A.M.-settled/P.M.-settled legs with the same expiration date as diagonal rather than a vertical, for purposes of the debit/credit price reasonability check, the proposed rule change will provide the same execution opportunities for legitimately priced vertical strategies with A.M.-settled/P.M.-settled legs in certain classes as it may for diagonal strategies in certain classes given then-current market conditions. Additionally, this handling of strategies with A.M.-settled/P.M.-settled legs with the same expiration date and different exercise prices as calendar spreads will provide those orders with opportunities to be accepted and executed, rather than be rejected because the debit/credit price reasonability checks views the orders as having legs with the same expiration dates and exercise prices and thus does not recognize it as a calendar spread.

As a result, the proposed rule change ultimately protects investors by continuing to prevent execution of spreads with A.M.-settled/P.M.-settled legs that cease trading on different days at potentially erroneous prices, while also providing additional execution opportunities for those spreads that may be legitimately priced given then-current market conditions but may currently be rejected when these orders are treated as vertical spreads for the purposes of the debit/credit reasonability check, or are not recognized as calendar spreads. This proposed application of the debit/credit price reasonability check promotes just and equitable principles of trade, as it is based on the same general option and volatility pricing principles the System currently uses to pair calls and puts for other complex orders that also stop trading on different days, and will result in the handling of strategies with legs that stop trading on different days in the same manner during unusual or volatile market conditions.

In addition to this, the Exchange notes that the proposed rule change would not raise any novel or unique issues for investors as the debit/credit reasonability check logic and Exchange-determined buffers, where applicable, would apply to strategies with A.M.-settled/P.M.-settled legs in the same manner as they do today for calendar and diagonal spreads, which also have legs that stop trading on different dates. The Exchange will continue to announce any changes to the parameters of the debit/credit reasonability check to market participants by Exchange notice, to regularly monitor the application of the debit/credit price reasonability check and for orders that may be executed at erroneous prices, to consider market conditions, investor demand, and other relevant factors when determining whether to modify the debit/credit reasonability check buffer or other risk control parameter amount in order to appropriately balance providing protection against executions at potentially erroneous prices and providing execution opportunities for legitimately priced orders.

In addition to this, the proposed rule change to codify the definition of diagonal spreads in Rule 5.34(b) would generally protect investors by adding clarity to the Rules regarding a strategy that is already described within the Rules and to which the System currently applies the debit/credit reasonability check and Exchange-determined price buffers.

Item 4. <u>Self-Regulatory Organization's Statement on Burden on Competition</u>

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 proposed rule change will not impose any burden on intramarket competition, because the debit/credit price reasonability check will continue to apply to all incoming complex orders of all TPHs in the same manner. The proposed rule change would allow the System to apply the logic and pre-set buffers to vertical spreads with A.M.-settled/P.M.-settled legs (and thus stop trading on different dates) that it already applies to other spreads that contain legs that stop trading on different dates and have different exercise prices (i.e., diagonals), as well as to apply the logic and pre-set buffers to spreads with A.M.-settled/P.M.-settled legs (and thus stop trading on different dates) that it already applies to other spreads that contain legs that stop trading on different dates and have the same exercise prices (i.e., calendars). This, in turn, will allow the System to apply the appropriate Exchange-determined buffer to such vertical orders, which the Exchange understands market participants price more similarly to a diagonal spread as opposed to a vertical spread, or to such calendar orders, given the difference in the actual trading days on which each leg stops trading, thus allowing for legitimately priced strategies with A.M.-settled/P.M.-settled legs to execute as intended.

The proposed rule change does not impose any burden on intermarket competition, as it is an enhancement to a price protection mechanism the System applies to complex orders submitted to the Exchange to determine whether they should be accepted for potential execution on the Exchange. The Exchange believes the proposed rule change would provide all market participants with additional execution opportunities when appropriate while still providing protection from anomalous or erroneous executions. To the extent that market participants find the proposed application of the debit/credit reasonability check to their vertical and calendar spreads with A.M.-

settled/P.M.-settled legs more favorable for execution of their legitimately priced orders, other exchanges may adopt functionality to similarly handle such complex strategies.

Additionally, the proposed rule change to codify the definition of diagonal spreads to the Rules is a nonsubstantive, noncompetitive change that merely provides additional clarity within the Rules regarding a term/strategy that is already described in the Rules and that the System already accounts for pursuant to the Rules.

Item 5. <u>Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others</u>

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

Item 6. <u>Extension of Time Period for Commission Action</u>

Not applicable.

Item 7. <u>Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)</u>

(a) The proposed rule change is filed for immediate effectiveness pursuant to Section 19(b)(3)(A) of Act[15] and Rule 19b-4(f)(6)[16] thereunder.

(b) The Exchange designates that the proposed rule change effects a change that (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) by its terms, does not become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest. Additionally, the Exchange has given the Commission written notice of its

---

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

16 17 CFR 240.19b-4(f)(6).

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 does not believe that the proposed rule change will significantly affect the protection of investors or the public interest because it is merely allowing the System to apply the debit/credit price reasonability check logic and Exchange-determined pre-set buffers already in place for calendar and diagonal spreads (which have legs that cease trading on different dates) to spreads with legs that have the same expiration dates but cease trading on different dates. The Exchange believes the proposed rule change will protect investors and the public interest by allowing the System to provide additional execution opportunities for legitimately priced spread orders with pair(s) of A.M.-settled/P.M.-settled legs that may currently be rejected while still protecting against execution at potentially erroneous prices.

The Exchange does not believe that the proposed rule change will impose any significant burden on competition because the debit/credit price reasonability check and pre-set buffers will continue to apply to all incoming complex orders of all TPHs in the same manner. The proposed rule change would allow the System to apply the logic and pre-set buffers to vertical spreads with A.M.-settled/P.M.-settled legs (and thus stop trading on different dates) that it already applies to other spreads that contain legs that stop trading on different dates and also have different exercise prices (i.e., diagonals), and would allow the System to apply the logic and pre-set buffers to spreads with A.M.-settled/P.M.-settled legs (and thus stop trading on different dates) that it already applies to other spreads that contain legs that stop trading on different dates and have the same exercise prices (i.e., calendars). This, in turn, will allow the System to apply the appropriate Exchange-determined buffer to such vertical orders, which the Exchange understands are priced more similarly to a diagonal spread as opposed to a vertical spread, or to such orders with the same exercise price, which the Exchange understands are priced more similarly to a calendar spread, given the difference in the last trading day, thus allowing opportunities for legitimately priced strategies with A.M.-settled/P.M.-settled legs to be accepted and executed as intended. The Exchange believes the proposed rule change would ultimately provide all market participants additional execution opportunities when appropriate while continuing to provide protection from anomalous or erroneous executions.

Additionally, the proposed rule change to codify the definition of diagonal spreads to Rule 5.34(b)(1) would not significantly affect the protection of investors or the public interest because it is a nonsubstantive change that merely provides additional clarity within the Rules regarding a term/strategy that is already described in the Rules and that the System already accounts for pursuant to the Rules.

The proposed rule change does not raise any novel or unique issues for investors as the debit/credit reasonability check logic and Exchange-determined buffers, where applicable, would apply to vertical strategies with A.M.-settled/P.M.-settled legs and legs with different exercise prices in the same manner as they do today for diagonal spreads, and would apply to strategies with A.M.-settled/P.M.-settled legs and legs with the same exercise prices in the same manner as they do today for calendar spreads which also have legs that stop trading on different dates. As stated above, to the extent that the proposed treatment of certain vertical spreads makes the Exchange a more attractive trading venue to market participants, other options exchanges may choose to adopt similar changes.

For the foregoing reasons, this rule filing qualifies as a "non-controversial" rule change under Rule 19b-4(f)(6), which renders the proposed rule change effective upon filing with the Commission. At any time within 60 days of the filing of this 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 will institute proceedings to determine whether the proposed rule change should be approved or disapproved.

The Exchange respectfully requests that the Commission waive the 30-day operative delay period after which a proposed rule change under Rule 19b-4(f)(6) becomes effective. The proposed rule change does not introduce any new or novel System functionality but merely seeks to apply existing System logic and pre-set buffers for debit/credit reasonability checks to spread orders with legs with the same expiration date but stop trading on different days in the same manner it does for calendar and diagonal spread orders, as applicable, which also have legs that stop trading on different days. Waiver of the operative delay will allow the Exchange to implement this enhancement as soon as practicable. As noted above, in volatile conditions, which may occur at any time, certain classes may experience backwardation. In such conditions, vertical spreads with an A.M.-settled leg and a P.M.-settled leg with the same expiration dates and the same or different exercise prices may be rejected pursuant to the debit/credit price check despite being legitimately priced given then-current market conditions, while calendars and diagonals in that class may be accepted. The Exchange also understands that market participants have voiced concerns regarding the System rejecting their legitimately priced A.M.-settled/P.M. settled calendar spreads and vertical spreads (especially closer in time to A.M./P.M. expiration dates which occur monthly). The Exchange believes waiver of the operative delay will protect investors by permitting the Exchange to apply a potentially widened buffer in such conditions to these vertical spreads, which the System currently handles as verticals, which may provide additional execution opportunities when volatile conditions arise, which have, particularly, been reoccurring in light of the COVID-19 pandemic's ongoing economic impacts. The waiver of the operative delay will also protect investors by permitting the System to recognize and accept these spreads as calendar spreads which the System currently rejects pursuant to the debit/credit price reasonability check due to each leg having the same expiration date and same exercise price. The Exchange plans to implement this change on October 16, 2020. For these reasons, the Exchange respectfully requests that the Commission waive the 30-day operative delay.

(c) Not applicable.

(d) Not applicable.

Item 8. **<u>Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission</u>**

The proposed rule change is not based on a rule either of another self-regulatory organization or of the Commission.

Item 9. **<u>Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act</u>**

Not applicable.

Item 10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

Item 11. Exhibits

Exhibit 1. Completed Notice of Proposed Rule Change for publication in the Federal Register.

Exhibit 5. Proposed rule text.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-   ; File No. SR-CBOE-2020-099]

[Insert date]

Self-Regulatory Organizations; Cboe Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Amend Rule 5.34 in Connection with its Debit/Credit Price Reasonability Check

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 [insert date], 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 Exchange filed the proposal as a "non-controversial" proposed rule change pursuant to Section 19(b)(3)(A)(iii) of the Act[3] and Rule 19b-4(f)(6) thereunder.[4] 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 amend Rule 5.34 in connection with its debit/credit price reasonability check. The text of the proposed rule change is provided in Exhibit 5.

---

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

[2] 17 CFR 240.19b-4.

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

[4] 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 proposed to amend Rule 5.34(b)(3), which provides for its debit/credit price reasonability check. Specifically, the proposed rule change amends Rule 5.34(b)(3)(A) in connection with two-legged strategies that have one A.M.-settled leg and one P.M.-settled leg with the same expiration date.[5] The proposed rule change also codifies the definition of diagonal spreads in Rule 5.34(b)(1)(E), which is already a strategy described in Rule 5.34(b)(3) and handled by the System in connection with the debit/credit reasonability check, the codified definition of which was inadvertently omitted in the rule

[5] The proposed rule change also updates the definition of vertical spread in Rule 5.34(b)(1)(A) and the definition of calendar spread in Rule 5.34(b)(1)(D) in light of the proposed change to Rule 5.34(b)(3)(A).

filing that allowed the System to apply the debit./credit reasonability check to diagonal spreads.[6]

Pursuant to the debit/credit price reasonability check, the Exchange cancels or rejects a complex order (or unexecuted portion) that is a limit order for a debit strategy with a net credit price that exceeds a pre-set buffer, a limit order (or unexecuted portion) for a credit strategy with a net debit price that exceeds a pre-set buffer, or a market order (or unexecuted portion) for a credit strategy that would execute at a net debit price that exceeds a pre-set buffer (the pre-set buffers are determined by the Exchange on a class and strategy (i.e., vertical, calendar, butterfly, orders with different expiration dates and exercise prices) basis). The System defines a complex order as a debit (credit) if all pairs and loners are debits (credits).[7] For purposes of the credit/debit price reasonability check, a "pair" is a pair of legs in an order for which both legs are calls or both legs are puts, one leg is a buy and one leg is a sell, and the legs have the same expiration date but different exercise prices (i.e., vertical)[8], the same exercise price but different expiration dates (i.e., calendar)[9], or the exercise price for the call (put) with the farther expiration date is lower (higher) than the

---

6 See Securities Exchange Release No. 88923 (May 21, 2020), 85 FR 32086 (May 28, 2020) (SR-CBOE-2020-046).

7 See Rule 5.34(b)(3)(B)(i) and (ii). The System also determines certain call and put butterfly spreads as debits and credits.

8 See also Rule 5.34(b)(1)(A), which defines a "vertical spread" as a two-legged complex order with one leg to buy a number of calls (puts) and one leg to sell the same number of calls (puts) with the same expiration date but different exercise prices.

9 See also Rule 5.34(b)(1)(D), which defines a "calendar spread" as a two-legged complex order with one leg to buy a number of calls (puts) and one leg to sell the same number of calls (puts) with the same exercise price but different expiration dates.

exercise price for the nearer expiration date (which is a diagonal pair). A “loner” is any leg in an order that the System cannot pair with another leg in the order.

The System determines whether an order is a debit or credit based on general options volatility and pricing principles, which the Exchange understands are used by market participants in their option pricing models. With respect to options with the same underlying:

- if two calls (puts) have the same expiration date, the price of the call (put) with the lower (higher) exercise price is more than the price of the call (put) with the higher (lower) exercise price; and
- if two calls (puts) have the same exercise price, the price of the call (put) with the nearer expiration is less than the price of the call (put) with the farther expiration.

In other words, a call (put) with a lower (higher) exercise price is generally more expensive than a call (put) with a higher (lower) exercise price, because the ability to buy stock at a lower price is more valuable than the ability to buy stock at a higher price, and the ability to sell stock at a higher price is more valuable than the ability to sell stock at a lower price. A call (put) with a farther expiration is generally more expensive than the price of a call (put) with a nearer expiration, because locking in a price further into the future involves more risk for the buyer and seller and thus is more valuable, making an option (call or put) with a farther expiration more expensive than an option with a nearer expiration. Based on the principles described above and pursuant to Rule 5.34(b)(3)(B)(iii), the System pairs calls (puts) under the current debit/credit reasonability check, as follows:

1) The System first pairs legs to the extent possible within each expiration date, pairing one leg with the leg that has the next highest exercise price.

2) The System then pairs legs to the extent possible across expiration dates, pairing one call (put) with the call (put) that has the next nearest expiration date and the same or next lower (higher) exercise price.

3) A pair of calls is a credit (debit) if the exercise price of the buy (sell) leg is higher than the exercise price of the sell (buy) leg (if the pair has the same expiration date) or if the expiration date of the sell (buy) leg is farther than the expiration date of the buy (sell) leg (if the exercise price of the sell (buy) leg is the same as or lower than the exercise price of the buy (sell) leg).

4) A pair of puts is a credit (debit) if the exercise price of the sell (buy) leg is higher than the exercise price of the buy (sell) leg (if the pair has the same expiration date) or if the expiration date of the sell (buy) leg is farther than the expiration date of the buy (sell) leg (if the exercise price of the sell (buy) leg is the same as or higher than the exercise price of the buy (sell) leg).

5) A loner to buy is a debit, and a loner to sell is a credit.

Additionally, the System does not apply the debit/credit price reasonability check to an order for which the System cannot define whether it is a debit or credit.

As indicated above, the debit/credit reasonability check allows the Exchange to determine a pre-set buffer on a class-by-class and strategy basis (i.e., vertical, calendar, butterfly, orders with different expiration dates and exercise prices). This flexibility allows the Exchange to appropriately respond to the different trading characteristics and market conditions that have unique impact across different classes and different strategies. For example, the Exchange understands that in certain market conditions, particularly in volatile conditions, the general pricing principles described above may not apply to certain classes or strategies. It is possible that the leg with the farther expiration may be trading at a discount and thus is worth less than the leg with the nearer term expiration, and thus entering a diagonal or calendar strategy as a debit may be consistent with the then-current market. Specifically, certain classes may exhibit backwardation,[10] which occurs when series with the farther expirations are worth less than series with the nearer term expirations. In such conditions, the Exchange may deem it appropriate to increase the buffer to permit these orders to be accepted for electronic processing. While an order with a diagonal or calendar strategy entered as a debit in normal market conditions may appear erroneous and be appropriately rejected, in volatile market conditions, such an order entered as a debit may be accurately reflecting the market. As such, the flexibility to establish pre-set buffers on a class and strategy basis currently permits the Exchange to provide a calendar or diagonal strategy order entered as a debit with electronic execution opportunities, as applicable, by modifying the buffer of these strategies with legitimate debit prices that are consistent with then-current market conditions. In this way, the System may accept such orders while maintaining the check's protection for classes and strategies whose pricing is not impacted by these market conditions and are not experiencing backwardation.

As stated above, for purposes of the debit/credit reasonability check, the System defines a vertical spread order as a two-legged complex order with one leg to buy a number of calls (puts) and one leg to sell the same number of calls (puts) with the same expiration date but different exercise prices,[11] and a calendar spread order as a two-legged complex

---

10 Specifically, European-settled options (which is a group of classes) may experience backwardation. For example, SPX is a European style option that may be impacted by backwardation in unusual or volatile market conditions. Accordingly, the Exchange regularly sets widened buffers for SPX diagonal pairs.

11 See Rule 5.34(b)(1)(A).

order with one leg to buy a number of calls (puts) and one leg to sell the same number of calls (puts) with the same exercise price but different expiration dates.[12] The Exchange notes that while the expiration date of the legs of a vertical or calendar spread with an A.M.-settled leg and a P.M.-settled leg may be the same, the last trading date of the two legs differs. For example, an S&P 500 Index ("SPX") option/SPX Weekly ("SPXW") vertical spread would contain the same expiration date, yet SPX options are A.M.-settled, thus they stop trading on the Thursday prior to Friday expiration, and SPXW options are P.M.-settled, thus they stop trading at the close on Friday expiration. As a result, the time to expiration of trading for each leg is different, which the Exchange understands is what market participants consider when pricing options with an A.M.-settled/P.M.-settled vertical strategy, similar to the pricing of a diagonal spread, or when pricing options with an A.M.-settled/P.M.-settled calendar strategy — in other words, market participants consider these legs to have different expiration dates. When applying the debit/credit reasonability check, however, the System currently considers a strategy with one P.M.-settled leg and one A.M.-settled leg with the same expiration date and different exercise prices to be a vertical strategy, rather than a diagonal strategy., and it rejects a strategy with one P.M.-settled leg and one A.M.-settled leg with the same expiration date and same exercise prices because it does not recognize this strategy as a calendar strategy. More specifically, the System and the Rules do not currently consider the difference in time between the actual close of trading for the A.M.-settled leg and the actual close of trading the following day for the P.M.-settled leg – it considers only that the legs have the same expiration date. As a result, the System does not determine the credit (debit) net price for vertical or calendar spread orders with a pair(s) of A.M.-

---

12 See Rule 5.34(b)(1)(D).

settled/P.M.-settled legs using the same pricing principles for the debit/credit reasonability check that the Exchange understands market participants use for these strategies, as market participants consider these spreads to have different expiration dates, and thus to be diagonals (rather than verticals) or calendars for pricing purposes. That is, if a sell (buy) leg is P.M.-settled (i.e., is "farther out" in time until trading actually ceases) and is a call (put) with an exercise price that is the same as or lower (higher) than the exercise price of the buy (sell) A.M.-settled leg (thus making the P.M.-settled leg more expensive), the System would not treat this as a diagonal spread, nor recognize it as a calendar spread, pursuant to Rule 5.34(b)(3)(B)(iii)(c) and (d), even though market participants would price these spreads as a diagonal (if the legs have different exercise prices) or calendar (if the legs have the same exercise price) from a pricing perspective.

Specifically, a vertical spread with A.M.-settled/P.M.-settled legs essentially emulates the manner in which a diagonal strategy executes, given that each leg in a diagonal strategy ceases trading at different times (because they have different expiration dates) and diagonal spread legs, like vertical spread legs, also have different exercise prices. Likewise, a spread with A.M.-settled/P.M.-settled legs with the same exercise price essentially emulates the manner in which a calendar spread executes, given that each leg in a calendar strategy ceases trading at different times (because they have different expiration dates). Under the proposal, the debit/credit reasonability check logic and Exchange-determined buffers, where applicable, would apply in the same manner as they do today for calendar and diagonal spreads, as applicable, to spreads with a pair(s) of A.M.-settled/P.M.-settled legs. Therefore, the proposed rule change amends Rule 5.34(b)(3)(A) to provide that, for the purposes of the debit/credit price reasonability check, the System considers a two-legged strategy with one P.M.-settled leg and one A.M.-settled leg with the same expiration date to be a diagonal spread (where both legs have different expiration dates and different exercise prices), rather than a vertical spread, or a calendar spread (where both legs have the same exercise price).[13] As a result, the System will apply to such vertical strategies, which are generally priced using the same principles as diagonal spreads and may be adjusted to reflect backwardation (as described above), the same debit/credit check logic and pre-set buffers that it currently applies to diagonal spreads. In addition, the System will apply to such strategies, which are generally priced using the same principles as calendar spreads, the same debit/credit check logic and pre-set buffers that it currently applies to calendar spreads and not reject such strategies because the legs have the same expiration dates and exercise prices. The Exchange believes the enhancing the debit/credit price reasonability check to consider a spread that contains a pair of A.M.-settled/P.M. settled legs with the same expiration date as a diagonal or calendar, as appropriate, will cause the System to apply more accurate pricing principles to them when determining whether to accept or reject strategies with A.M.-settled/P.M.-settled legs.

Regarding vertical spreads with A.M.-settled/P.M.-settled legs with the same expiration date and different exercise prices,, currently, if the System receives such a vertical spread order, and the exercise price for the sell leg is lower than the exercise price of the buy leg with a debit price, the System will determine this to be a credit and reject it (assuming it is outside of the buffer). However, if the class is experiencing backwardation, the debit price may be appropriate. As discussed above, the Exchange may widen the buffer for such a class in such circumstances for calendars and diagonals to account for the backwardation.

---

13 See supra note 5.

Therefore, if the System receives a spread with A.M.-settled/P.M.-settled legs in a class experiencing backwardation during unusual or volatile market conditions, the System would apply a different buffer to that spread than it would apply to a diagonal spread. While the A.M.-settled/P.M.-settled vertical spread would likely have been priced using the same pricing principles as the diagonal spread, the System would reject the vertical spread order, despite it likely having a legitimate price, while accepting the diagonal order with a similarly legitimate price. Pursuant to the proposed rule change the strategy described above would be handled as a diagonal and will have the opportunity to be accepted and executed. Similarly, the System will recognize a spread with A.M.-settled/P.M.-settled legs with the same expiration date and the same exercise price as a calendar spread and not reject such spread order.

The Exchange notes that it announces any changes to the parameters of the debit/credit reasonability check to market participants by Exchange notice pursuant to Rule 1.5. The Exchange notes too that it will continue to regularly monitor the application of the debit/credit price reasonability check, including the number of orders rejected as a result of the check, as well as continue to monitor orders that may be executed at erroneous prices pursuant to Rule 6.5. The Exchange currently considers all of these factors, as well as market conditions, investor demand, and other relevant factors when determining whether to modify the debit/credit reasonability check buffer or other risk control parameters in order to attempt to create an appropriate balance between protection against executions at potentially erroneous prices and provision of execution opportunities for legitimately priced orders.

In addition to this, the proposed rule change codifies the definition of diagonal spreads in the current spread definitions in Rule 5.34(b)(1). Specifically, proposed Rule

5.34(b)(1)(E) provides that a "diagonal" spread is a two-legged complex order with one leg to buy a number of calls (puts) and one leg to sell the same number of calls (puts) with different expiration dates and different exercise prices. As noted above, diagonal spreads are currently described within Rule 5.34(b) and the System currently applies the debit/credit reasonability check and Exchange-determined buffers to diagonal spreads pursuant to Rule 5.34(b)(3)(A).[14] The Exchange merely inadvertently omitted codifying the definition of diagonal spreads in a previous rule filing that updated Rule 5.34 to allow the System to apply the debit/credit reasonability check to diagonals.[15]

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.[16] Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)[17] 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

---

14 In light of the proposed codified definition, the Exchange updates the current description of a diagonal in Rule 5.34(b)(3)(A) to, instead, refer to "diagonal", as well as adds this reference to the description of a diagonal in Rule 5.34(b)(3)(B)(iii).

15 See supra note 6.

16 15 U.S.C. 78f(b).

17 15 U.S.C. 78f(b)(5).

interest. Additionally, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)[18] 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 perfects the mechanism of a free and open market and national market system by applying the current debit/credit price reasonability check logic for diagonal spreads (which have different expiration dates and thus cease trading on different dates, as well as different exercise prices) to spread orders with A.M.-settled/P.M.-settled legs that have different exercise prices but the same expiration date (and are thus currently defined as verticals) but similarly cease trading on different dates. Additionally, it will allow the System to recognize spreads with A.M.-settled/P.M.-settled legs that have the same exercise price and the same expiration date, but likewise cease trading on different dates, to be calendar spreads (which have different expiration dates and the same exercise price). By considering these particular orders to be diagonals rather than verticals, or to be calendars, the Exchange will apply the same buffers to vertical strategies that have legs that stop trading at different times (i.e., one leg is A.M-settled and one leg is P.M.-settled) as it applies to diagonal strategies (which also have legs that stop trading at different times), and will apply the same buffers to strategies that have legs that stop trading at different times (i.e., one leg is A.M-settled and one leg is P.M.-settled) and the same exercise price as it applies to calendar strategies. This handling of vertical spreads is appropriate in classes in which market conditions may cause the P.M.-settled leg (with the farther time until trading expiration) to trade at a discount and be

---

18 Id.

worth less than the A.M.-settled leg (with the nearer time until trading expiration). By considering a vertical strategy with A.M.-settled/P.M.-settled legs with the same expiration date as diagonal rather than a vertical, for purposes of the debit/credit price reasonability check, the proposed rule change will provide the same execution opportunities for legitimately priced vertical strategies with A.M.-settled/P.M.-settled legs in certain classes as it may for diagonal strategies in certain classes given then-current market conditions. Additionally, this handling of strategies with A.M.-settled/P.M.-settled legs with the same expiration date and different exercise prices as calendar spreads will provide those orders with opportunities to be accepted and executed, rather than be rejected because the debit/credit price reasonability checks views the orders as having legs with the same expiration dates and exercise prices and thus does not recognize it as a calendar spread.

As a result, the proposed rule change ultimately protects investors by continuing to prevent execution of spreads with A.M.-settled/P.M.-settled legs that cease trading on different days at potentially erroneous prices, while also providing additional execution opportunities for those spreads that may be legitimately priced given then-current market conditions but may currently be rejected when these orders are treated as vertical spreads for the purposes of the debit/credit reasonability check, or are not recognized as calendar spreads. This proposed application of the debit/credit price reasonability check promotes just and equitable principles of trade, as it is based on the same general option and volatility pricing principles the System currently uses to pair calls and puts for other complex orders that also stop trading on different days, and will result in the handling of strategies with legs that stop trading on different days in the same manner during unusual or volatile market conditions.

In addition to this, the Exchange notes that the proposed rule change would not raise any novel or unique issues for investors as the debit/credit reasonability check logic and Exchange-determined buffers, where applicable, would apply to strategies with A.M.-settled/P.M.-settled legs in the same manner as they do today for calendar and diagonal spreads, which also have legs that stop trading on different dates. The Exchange will continue to announce any changes to the parameters of the debit/credit reasonability check to market participants by Exchange notice, to regularly monitor the application of the debit/credit price reasonability check and for orders that may be executed at erroneous prices, to consider market conditions, investor demand, and other relevant factors when determining whether to modify the debit/credit reasonability check buffer or other risk control parameter amount in order to appropriately balance providing protection against executions at potentially erroneous prices and providing execution opportunities for legitimately priced orders.

In addition to this, the proposed rule change to codify the definition of diagonal spreads in Rule 5.34(b) would generally protect investors by adding clarity to the Rules regarding a strategy that is already described within the Rules and to which the System currently applies the debit/credit reasonability check and Exchange-determined price buffers.

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 proposed rule change will not impose any burden on intramarket competition, because the debit/credit price reasonability check will continue to apply to all incoming complex orders of all TPHs in the same manner. The proposed rule change would allow the System to apply the logic and pre-set buffers to vertical spreads with A.M.-settled/P.M.-settled legs (and thus stop trading on different dates) that it already applies to other spreads that contain legs that stop trading on different dates and have different exercise prices (i.e., diagonals), as well as to apply the logic and pre-set buffers to spreads with A.M.-settled/P.M.-settled legs (and thus stop trading on different dates) that it already applies to other spreads that contain legs that stop trading on different dates and have the same exercise prices (i.e., calendars). This, in turn, will allow the System to apply the appropriate Exchange-determined buffer to such vertical orders, which the Exchange understands market participants price more similarly to a diagonal spread as opposed to a vertical spread, or to such calendar orders, given the difference in the actual trading days on which each leg stops trading, thus allowing for legitimately priced strategies with A.M.-settled/P.M.-settled legs to execute as intended.

The proposed rule change does not impose any burden on intermarket competition, as it is an enhancement to a price protection mechanism the System applies to complex orders submitted to the Exchange to determine whether they should be accepted for potential execution on the Exchange. The Exchange believes the proposed rule change would provide all market participants with additional execution opportunities when appropriate while still providing protection from anomalous or erroneous executions. To the extent that market participants find the proposed application of the debit/credit reasonability check to their vertical and calendar spreads with A.M.-

settled/P.M.-settled legs more favorable for execution of their legitimately priced orders, other exchanges may adopt functionality to similarly handle such complex strategies.

Additionally, the proposed rule change to codify the definition of diagonal spreads to the Rules is a nonsubstantive, noncompetitive change that merely provides additional clarity within the Rules regarding a term/strategy that is already described in the Rules and that the System already accounts for pursuant to the Rules.

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:

A. significantly affect the protection of investors or the public interest;

B. impose any significant burden on competition; and

C. 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[19] and Rule 19b-4(f)(6)[20] thereunder. 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,

---

[19] 15 U.S.C. 78s(b)(3)(A).

[20] 17 CFR 240.19b-4(f)(6).

the Commission will 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. Please include File Number SR-CBOE-2020-099 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-2020-099. 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, D.C. 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; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-CBOE-2020-099 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.[21]

Secretary

---

[21] 17 CFR 200.30-3(a)(12).

EXHIBIT 5

(additions are <u>underlined</u>; deletions are [bracketed])

* * * * *

Rules of Cboe Exchange, Inc.

* * * * *

Rule 5.34. Order and Quote Price Protection Mechanisms and Risk Controls

The System's acceptance and execution of orders, quotes, and bulk messages, as applicable, pursuant to the Rules, including Rules 5.31 through 5.33, and orders routed to PAR pursuant to Rule 5.82 are subject to the following price protection mechanisms and risk controls, as applicable.

(a) No change.

(b) *Complex Orders*.

(1) *Definitions*. For the purposes of this subparagraph (b):

(A) *Vertical Spread*. A "vertical" spread is a two-legged complex order with one leg to buy a number of calls (puts) and one leg to sell the same number of calls (puts) with the same expiration date but different exercise prices<u>, except as set forth in subparagraph (b)(3)(A) below</u>.

(B)-(C) No change.

(D) *Calendar Spread*. A "calendar" spread is a two-legged complex order with one leg to buy a number of calls (puts) and one leg to sell the same number of calls (puts) with the same exercise price but different expiration dates<u>, except as set forth in subparagraph (b)(3)(A) below</u>.

<u>(E) *Diagonal Spread*. A "diagonal" spread is a two-legged complex order with one leg to buy a number of calls (puts) and one leg to sell the same number of calls (puts) with different expiration dates and different exercise prices.</u>

(2) No change.

(3) *Debit/Credit Price Reasonability Checks*.

(A) The Exchange cancels or rejects a complex order (or unexecuted portion) that is a limit order for a debit strategy with a net credit price that exceeds a pre-set buffer, a limit order (or unexecuted portion) for a credit strategy with a net debit price that exceeds a pre-set buffer, or a market order (or unexecuted portion) for a credit strategy that would execute at a net debit price that exceeds a pre-set buffer (the pre-set buffers are determined by the Exchange on a class and strategy (i.e., vertical, calendar, butterfly, [orders with different expiration dates and exercise prices]diagonal) basis). For the purposes of this check, the System considers a two-legged strategy with one P.M.-settled leg and one A.M.-settled leg with the same expiration date to be a diagonal spread (where both legs have different exercise prices), rather than a vertical spread, or a calendar spread (where both legs have the same exercise price).

(B) The System defines a complex order as a debit or credit as follows:

(i)-(ii) No change.

(iii) an order for which all pairs and loners are debits (credits) is a debit (credit). For purposes of this check, a "pair" is a pair of legs in an order for which both legs are calls or both legs are puts, one leg is a buy and one leg is a sell, and the legs have the same expiration date but different exercise prices (i.e., vertical), the same exercise price but different expiration dates (i.e., calendar), or the exercise price for the call (put) with the farther expiration date is lower (higher) than the exercise price for the nearer expiration date (i.e., diagonal). A "loner" is any leg in an order that the System cannot pair with another leg in the order. Notwithstanding the foregoing, if the stock component of a stock-option order is to buy (sell), the stock-option order is a debit (credit).

* * * * *