

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-90241; File No. SR-C2-2020-016)

October 21, 2020

Self-Regulatory Organizations; Cboe C2 Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Enhance its Drill-through Protections and Make Other Clarifying Changes

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> notice is hereby given that on October 9, 2020, Cboe C2 Exchange, Inc. (“Exchange” or “C2”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

Cboe C2 Exchange, Inc. (the “Exchange” or “C2”) proposes to enhance its drill-through protections and make other clarifying changes. The text of the proposed rule change is provided in Exhibit 5.

The text of the proposed rule change is also available on the Exchange’s website ([http://markets.cboe.com/us/options/regulation/rule\\_filings/ctwo/](http://markets.cboe.com/us/options/regulation/rule_filings/ctwo/)), 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

---

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

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

proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The Exchange proposes to enhance its drill-through protections for simple and complex orders and make other clarifying changes. Currently, pursuant to Rule 6.14(a)(4) and (b)(6), the System will execute a marketable buy (sell) order or complex order,<sup>3</sup> respectively, up to a buffer amount above (below) the limit of the Opening Collar or the national best offer (“NBO”) (national best bid (“NBB”)), as applicable, or the synthetic national best offer (“SNBO”) or synthetic national best bid (“SNBB”), respectively (the “drill-through price”). The System enters any order (or unexecuted portion), simple<sup>4</sup> or complex, into the book or the complex order book (“COB”), respectively, at the drill-through price for a specified period of time (determined by the Exchange).<sup>5</sup> At the end of the time period, the System cancels any portion of the order not executed during that time period.

---

<sup>3</sup> The System may also initiate a complex order auction (“COA”) at the drill-through price for a complex order that would otherwise initiate a COA.

<sup>4</sup> Market orders or limit orders (or unexecuted portions) with times-in-force of immediate-or-cancel (“IOC”) or fill-or-kill (“FOK”) are cancelled rather than be entered into the book. Limit orders with times-in-force of day, good-til-cancelled (“GTC”), or good-til-day (“GTD) may enter the book.

<sup>5</sup> The current time period is two seconds, and the current default amounts are available in the technical specifications available at [https://cdn.cboe.com/resources/membership/US\\_Options\\_BOE\\_Specification.pdf](https://cdn.cboe.com/resources/membership/US_Options_BOE_Specification.pdf). Upon implementation of the proposed rule change, the Exchange will likely reduce the length of the time period and maintain the same buffer amounts.

The Exchange proposes to permit orders to rest in the book or COB, as applicable, for multiple time periods and at more aggressive displayed prices during each time period.<sup>6</sup> Specifically, for a limit order (or unexecuted portion) with a Time-in-Force of Day, GTC, or GTD, or a complex order, the System enters the order in the Book or COB with a displayed<sup>7</sup> price equal to the drill-through price (as discussed below, if an order's limit price is less aggressive than the drill-through price, the order will rest in the Book or COB, as applicable, at its limit price and subject to the User's instructions, and the drill-through mechanism as proposed to be amended would no longer apply to the order).<sup>8</sup> The order (or unexecuted portion) will rest in the book or COB, as applicable, until the earlier to occur of the order's full execution or the end of the duration of the number of time periods.<sup>9</sup> Following the end of each period prior to the final period, the System adds (if a buy order) or subtracts (if a sell order) one buffer amount to the drill-through price displayed during the immediately preceding period (each new price becomes the "drill-through price").<sup>10</sup> The order (or unexecuted portion) rests in the book or COB, as applicable, at that new

---

<sup>6</sup> The Exchange will announce to Trading Permit Holders the buffer amount, the number of time periods, and the length of the time periods in accordance with Rule 1.2. The Exchange notes that each time period will be the same length (as designated by the Exchange), and the buffer amount applied for each time period will be the same.

<sup>7</sup> Currently, the drill-through price is the price of orders and complex orders in the book or COB, respectively. The proposed rule change clarifies that the drill-through price is displayed, which is consistent with current functionality.

<sup>8</sup> See proposed Rule 6.14(a)(4)(C) and (b)(6)(B).

<sup>9</sup> The Exchange will determine on a class-by-class basis the number of time periods, which may not exceed five, and the length of the time period, which may not exceed three seconds. See proposed Rule 6.14(a)(4)(C)(i) and (b)(6)(B)(i). The proposed rule change adds class flexibility so that the Exchange may determine different time periods and buffer amounts for different classes, which may exhibit different trading characteristics and have different market models.

<sup>10</sup> The System will apply a timestamp to the order (or unexecuted portion) based on the time it enters or is re-priced in the book or COB, as applicable, for priority purposes. See proposed Rule 6.14(a)(4)(C)(iii) and (b)(6)(B)(iii). This is consistent with the current drill-through functionality, pursuant to which the System applies a timestamp to the order

drill-through price for the duration of the subsequent period. Following the end of the final period, the System cancels the simple or complex order (or unexecuted portion) not executed during any time period.<sup>11</sup> The Exchange has received feedback from Users that the current application of the drill-through mechanism is too limited. The Exchange believes this proposed rule change will provide additional execution opportunities for these orders (or unexecuted portions) while providing protection against execution at prices that may be erroneous.

For example, suppose the Exchange's market for a series in a class with a 0.05 minimum increment is 0.90 – 1.00, represented by a quote for 10 contracts on each side (the quote offer is Quote A). The following sell orders or quote offers for the series also rest in the book:

- Order A: 10 contracts at 1.05;
- Quote B: 10 contracts at 1.10;
- Order B: 10 contracts at 1.15; and
- Order C: 20 contracts at 1.25.

The market for away exchanges is 0.80 – 1.45. The Exchange's buffer amount for the class is 0.10, the drill-through resting time period is one second, and the number of time periods is three. The System receives an incoming order to buy 100 at 1.40, which executes against resting orders and quotes as follows: 10 against Quote A at 1.00 (which is the national best offer), 10 against Order A at 1.05, and 10 against Quote B at 1.10. The System will not automatically execute any of the remaining 70 contracts from the incoming buy order against Order B, because 1.15 is more than

---

(or unexecuted portion) based on the time it enters the book or COB, as applicable, modified to reflect the multiple price levels at which an order may rest. See current Rule 6.14(a)(4)(C) and (b)(6)(A).

<sup>11</sup> Note current Rule 6.14(a)(4)(C) and (b)(6)(B) uses the language “cancel or reject” while the proposed rule change deletes “reject,” as both terms have the same result and merely relate to internal System code, making the use of both terms unnecessary.

0.10 away from the national best offer at the time of order entry of 1.00 and thus exceeds the drill-through price check. The 70 unexecuted contracts then rest in the book for one second at a price of 1.10 (the initial drill-through price). No incoming orders are entered during that one-second time period to trade against the remaining 70 contracts. The System then re-prices the buy order in the book at a new drill-through price of 1.20 (drill-through price plus one buffer of 0.10). Ten contracts immediately execute against Order B at a price of 1.15 (the buy order is still handled as the “incoming order” that executes against the resting Order B, and thus receives price improvement to 1.15). An incoming order to sell 20 contracts at 1.20 enters the book and executes against 20 of the resting contracts at that price. At the end of the second one-second time period, there are 40 remaining contracts. These contracts then rest in the book at a price of 1.30 for the final one second time period. Twenty contracts immediately execute against Order C at a price of 1.25. No incoming orders are entered during that time period to trade against the remaining 20 contracts. At the end of the final one-second time period, the System cancels the remaining 20 contracts.<sup>12</sup>

Currently, Users may establish a higher or lower buffer amount than the default amount set by the Exchange with respect to complex orders subject to the drill-through protection.<sup>13</sup> Pursuant to the proposed rule change, if a User establishes its own buffer amount, the drill-through protection will work as it does today. In other words, if a User establishes its own buffer amount, a complex order will rest in the COB for one time period at the drill-through price and any unexecuted portion will be cancelled at the end of the time period. The proposed rule change clarifies that the length of the time period will continue to be determined by the Exchange, and will be the same as the length of the time period that applies to complex orders for which the User does not establish its own

---

<sup>12</sup> The proposed drill-through protection for complex orders works in an identical manner.

<sup>13</sup> See Rule 6.14(b)(6) (proposed subparagraph (b)(6)(A)).

buffer amount. The Exchange believes this is consistent with a User's desire to set its own buffer to accommodate its own risk tolerance. All Users have the ability either to establish their own buffer amounts for complex orders, and thus have unexecuted orders rest for one time period, or let their complex orders be subject to the Exchange default buffer amount for complex orders, and thus have unexecuted orders rest at multiple price points for multiple time periods, as proposed.

The proposed rule change also makes certain clarifying and nonsubstantive changes, including movement of certain terms and provisions within Rule 6.14(a)(4) and (b)(6) due to the proposed rule changes described above. First, the proposed rule change combines the provisions in current subparagraphs (A) and (B) of Rule 6.14(a)(4) into proposed subparagraph (A). The drill-through protection in the following subparagraphs of Rule 6.14(a)(4) (currently and as proposed) apply to orders that enter the Book at the conclusion of the opening auction and intraday in the same manner. Current Rule 6.14(a)(4)(B) (the second subparagraph (B) and (C) (proposed subparagraphs (B) and (C)) provide that the System handles orders not executed pursuant to current subparagraph (A) in accordance with those subparagraphs, inadvertently omitting that current subparagraphs (B) (the second subparagraph (C) [sic] and (C) (and proposed subparagraphs (B) and (C)) also apply to orders described in current first subparagraph (B).<sup>14</sup> The proposed rule change clarifies that the drill-through protection applies to all orders that would enter the Book at prices worse than the drill-through price, including orders not executed during the opening auction and orders entered intraday. This is consistent with and a clarification of current functionality.

---

<sup>14</sup> The Exchange notes that current Rule 6.14(a)(4) inadvertently has two subparagraphs lettered (B). The proposed rule change, as describes above, incorporates the provisions from the first subparagraph (B) into subparagraph (A) and retains the second subparagraph (B) as the only subparagraph (B).

Second, the proposed rule change adds clarifying language regarding how the System handles orders for which the limit price is equal to or less than (if a buy order) or greater than (if a sell order) the drill-through price. Current Rule 6.14(b)(6) contemplates that complex orders with limit prices equal to or less aggressive than the drill-through price will not be subject to the mechanism pursuant to which orders will rest in the COB for a time period and then be cancelled. Specifically, Rule 6.14(b)(6)(A) states if a buy (sell) complex order would execute or enter the COB at a price *higher (lower) than the drill-through price*, the System enters the complex order into the COB with a price equal to the drill-through price and rests for the time period in accordance with the drill-through mechanism. Additionally, Rule 6.14(b)(6)(B) states that any complex order with a displayed price equal to the drill-through price (*unless the drill-through price equals the order's limit price*) will rest in the COB for the drill-through time period. Therefore, currently, if the limit price of a complex order is less aggressive than or equal to the drill-through price (i.e., if a buy (sell) complex order (or unexecuted portion) would execute or enter the COB at a price lower (higher) than or equal to the drill-through price), the complex order will rest in the COB, as applicable, and the drill-through mechanism stops (i.e., the time period will not occur and the System will not cancel the order). This is also true for simple orders but is not specified in the current Rules.

The proposed rule change clarifies that notwithstanding the provisions described above regarding an order or complex order resting in the book or COB, respectively, for brief time periods at drill-through prices, if a buy (sell) order's limit price equals or is less (greater) than the drill-through price at any time during application of the drill-through mechanism, the order rests in the book or COB, as applicable, subject to a User's instructions,<sup>15</sup> at its limit price and any remaining

---

<sup>15</sup> For example, the order will remain in force subject to any time-in-force instruction applied to the order by the User upon entry.

time period(s) described above do not occur.<sup>16</sup> If the drill-through price is equal to or more aggressive than the order's limit price, the additional protection of having the order rest in the COB for a short time period is not necessary given that the order will rest at the limit price entered by the User (and thus an acceptable execution price for that User). Additionally, displaying an order at a drill-through price (a price at which execution is possible) worse than the limit price of the order would be inconsistent with the terms of the order. This is consistent with current functionality (updated to reflect the proposed rule change to allow multiple time periods) and the definition of limit orders and merely clarifies this in the Rules.

Third, the proposed rule change corrects the market order reference in current and proposed Rule 6.14(a)(4)(C) (to limit order. That subparagraph relates to orders with times-in-force of day, GTC, or GTD that will rest in the book for a time period at the drill-through price. However, market orders by definition<sup>17</sup> do not rest in the book and would not have those times-in-force, which are contrary to the character of market orders. The System applies the functionality described in that subparagraph to limit orders with those times-in-force. The proposed rule change conforms the rule to current System functionality and to the definition of market and limit orders, as limit orders not fully executed upon entry will rest in the book while market orders not fully executed upon entry will be cancelled and not rest in the book.<sup>18</sup>

---

<sup>16</sup> See proposed Rule 6.14(a)(4)(C)(iv) and (b)(6)(B)(iv).

<sup>17</sup> See Rule 5.6(b).

<sup>18</sup> The proposed rule change also reorders the terms limit and market orders in current Rule 6.14(a)(4)(B) (the second subparagraph (B), which is proposed subparagraph (a)(4)(B)). As noted above, current Rule 6.14(a)(4) inadvertently has two subparagraphs lettered (B). The proposed rule change, as describes above, incorporates the provisions from the first subparagraph (B) into subparagraph (A) and retains the second subparagraph (B) as the only subparagraph (B). This is a nonsubstantive change, as the times-in-force of immediate-or-cancel or fill-or-kill described in that subparagraph are applicable to limit orders rather than market orders, which by definition are immediate-or-cancel.



Fourth, the proposed rule change clarifies in proposed Rule 6.14(b)(6)(B)(ii) that if the synthetic best bid or offer (“SBBO”) changes prior to the end of any time period but the complex order cannot leg into the simple book, and the new SBB or SBO, as applicable, crosses the drill-through price, the System changes the displayed price of the complex order to the new SBB or SBO, as applicable, plus or minus the applicable minimum increment for the class. The current Rule states that \$0.01 is added to or subtracted from the new SBBO. However, a class may have a minimum increment other than \$0.01 pursuant to Rule 5.4(b). Currently, the System adds or subtracts the applicable minimum increment. The proposed rule change corrects an inadvertent error in the Rules to conform to current System functionality and Rules regarding minimum increments for complex orders. The proposed rule change will ensure that a complex order will rest in the COB only with a displayed price in the applicable minimum increment applicable for the class of that complex order. The proposed rule change also clarifies that the complex order will rest in the COB (the current rule text says the complex order is not cancelled), and adds detail that the complex order rests at that displayed price, subject to a User’s instructions, and if it was not the final period, any remaining time period(s) do not occur.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Securities Exchange Act of 1934 (the “Act”) and the rules and regulations thereunder applicable to the Exchange and, in particular, the requirements of Section 6(b) of the Act.<sup>19</sup> Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>20</sup> requirements that the rules of an exchange be designed to prevent fraudulent and manipulative acts and

---

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

<sup>20</sup> 15 U.S.C. 78f(b)(5).

practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. Additionally, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>21</sup> 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 enhancement to the drill-through mechanism removes impediments to and perfects the mechanism of a free and open market and a national market system, and, in general, protects investors and the public interest. The proposed rule change will permit orders (or unexecuted portions) to rest in the book or COB, as applicable, at different displayed prices for a brief but overall longer period of time, which will provide market participants' orders with additional execution opportunities while continuing to protect them against execution at potentially erroneous prices. The proposed enhancement to the drill-through protection is similar to current drill-through functionality. The Exchange may determine the buffer amount for orders and the time period in which orders may rest in the book or COB. The proposed rule change permits an order to rest at multiples of the buffer amount, which would have the same effect as the Exchange setting a larger buffer amount. For example, if the Exchange set a buffer amount of \$0.75, that would allow orders to execute at any price no further than \$0.75 away from the NBBO or SNBBO at the time of order entry (including at prices \$0.25 and \$0.50 away from the NBBO or SNBBO at the time of order entry). This allows for the same potential execution prices that would be possible if the Exchange set a buffer of \$0.25 and three

---

<sup>21</sup> Id.

time periods under the proposed rule change. While the overall time period for which an order may rest in the book or COB may be longer than the currently permissible time period, the longer time period will still be relatively brief (maximum of 15 seconds). The Exchange notes it may maintain the same buffer amounts that are in place today. However, rather than increase the buffer amount at one time, the proposed rule change adds the overall larger buffer amount incrementally over a potentially overall longer time period. While this may permit executions at prices farther away from the NBBO or SNBBO at the time of order entry, it will still never permit executions at prices through orders' limit prices. This will provide execution opportunities for orders at incremental amounts away from the NBBO or SNBBO, as applicable, over a slightly longer time period and thus against a potentially larger number of orders. Users also have the ability to cancel orders prior to the completion of the time periods if they do not want the orders resting for a longer period of time (and Users can set their own buffer for complex orders, which would cause those complex orders to rest for a single time period rather than multiple as proposed).

The Exchange believes the proposed clarifying and nonsubstantive changes to the drill-through protection rules protect investors by adding transparency to the rules regarding the drill-through functionality. These changes are consistent with current functionality and thus do not impact the applicability of the drill-through mechanism to orders.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange does not believe that the proposed rule change will impose any burden on intramarket competition that is not necessary or appropriate in furtherance of the purposes of the Act because the enhanced drill-through protection will apply to all marketable orders in the same manner.

Users may cancel orders resting on the Book during the drill-through time periods or set their own buffer with respect to complex orders if they do not want their orders resting for a longer period of time as proposed.

The Exchange does not believe that the proposed rule change will impose any burden on intermarket competition that is not necessary or appropriate in furtherance of the purposes of the Act because it relates solely to how and when marketable orders will rest on the Exchange's book or COB. The proposed enhancement to the drill-through protection is consistent with the current protection and provides orders subject to the protection with additional execution opportunities while providing continued protection against execution against potentially erroneous prices.

The Exchange believes the proposed rule change would ultimately provide all market participants with additional execution opportunities when appropriate while providing protection from erroneous execution. The Exchange believes the proposal will enhance risk protections, the individual firm benefits of which flow downstream to counterparties both at the Exchange and at other options exchanges, which increases systemic protections as well. The Exchange believes enhancing risk protections will allow Users to enter orders and quotes with further reduced fear of inadvertent exposure to excessive risk, which will benefit investors through increased liquidity for the execution of their orders. Without adequate risk management tools, such as the one proposed to be enhanced in this filing, Trading Permit Holders could reduce the amount of order flow and liquidity they provide. Such actions may undermine the quality of the markets available to customers and other market participants. Accordingly, the proposed rule change is designed to encourage Trading Permit Holders to submit additional order flow and liquidity to the Exchange. The proposed flexibility may similarly provide additional execution

opportunities, which further benefits liquidity in potentially volatile markets. In addition, providing Trading Permit Holders with more tools for managing risk will facilitate transactions in securities because, as noted above, Trading Permit Holders will have more confidence protections are in place that reduce the risks from potential system errors and market events.

The proposed clarifying and nonsubstantive changes are consistent with current functionality and are intended to add clarity to the Rules, and thus the Exchange expects those changes to have no competitive impact.

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

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

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>22</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>23</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is: (i) necessary or appropriate in the public interest; (ii) for the protection of investors; or (iii) otherwise in furtherance of the purposes of the Act. If the Commission takes such action,

---

<sup>22</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>23</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6)(iii) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act.

Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>);
- or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-C2-2020-016 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-C2-2020-016. 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-C2-2020-016 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>24</sup>

J. Matthew DeLesDernier  
Assistant Secretary

---

<sup>24</sup> 17 CFR 200.30-3(a)(12).