Cboe

May 4, 2023

Christopher J. Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Cboe Futures Exchange, LLC Rule Certification
        Submission Number CFE-2023-007

Dear Mr. Kirkpatrick:

Pursuant to Section 5c(c)(1) of the Commodity Exchange Act, as amended ("Act"), and Regulation 40.6(a) promulgated by the Commodity Futures Trading Commission ("CFTC" or "Commission") under the Act, Cboe Futures Exchange, LLC ("CFE" or "Exchange") hereby submits a CFE rule amendment ("Amendment") to revise the descriptions of two risk control functions for options on futures and to further clarify how cancel replace/modify orders function when the original order has been partially executed. Exhibit 1 to this submission sets forth the rule changes included in the Amendment.   The Amendment will become effective on or after May 18, 2023, on an implementation date to be announced by the Exchange through the issuance of an Exchange notice.

Risk Control Updates

CFE plans to offer options on futures for trading on CFE. CFE previously submitted to the Commission CFE Rule Certification Submission Number CFE-2023-002 ("CFE-2023-002") to update CFE's rules to address the changes to CFE's current trading system and the new trading system functionality that CFE is implementing in order to accommodate the trading of options on futures on CFE. Among other things, CFE-2023-002 included updates to CFE Rule 513A (Risk Controls). CFE is now further revising Rule 513A in connection with the planned launch of trading in options on futures on CFE (which are referred to as Options in CFE rules) to update and include additional description regarding the risk control features for Options.   CFE is also taking this opportunity to further clarify in CFE Rule 406 (Execution of Orders by CFE System) how cancel replace/modify orders function when the original order has been partially executed.

Price Reasonability Check Risk Control

First, CFE is modifying Rule 513A(d) (Futures and Options Limit Order Price Reasonability Checks) as amended by CFE-2023-002 to update the manner in which CFE's limit order price reasonability check functions for Options.

As amended by CFE-2023-002, Rule 513A(d) provides that the Exchange shall designate limit order price reasonability percentage parameters by product for futures (referred to as Futures in CFE rules) and Options and that those percentages will be set forth in the rules governing the

applicable product. Additionally, Rule 513A(d) provides that CFE Clearing Members and Trading Privilege Holders ("TPHs") shall have the ability to designate limit order price reasonability percentage parameters by Executing Firm ID ("EFID") and product and that the most restrictive applicable limit order price reasonability percentage that is designated shall apply.

The limit order price reasonability check risk control functions in the following manner in relation to Options under Rule 513A(d) as amended by CFE-2023-002. The risk control rejects or cancels back to the sender any single leg Options buy order with a limit price that is equal to or more than the applicable designated percentage above the prevailing best offer and any single leg Options sell order with a limit price that is equal to or more than the applicable designated percentage below the prevailing best bid. The risk control also rejects or cancels back to the sender any buy order for an Options spread with a limit price that is equal to or more than the applicable designated percentage above the prevailing best offer in the applicable spread as reflected by any pending opposite side spread orders and the Implied Spread Offer for that spread and any sell order for an Options spread with a limit price that is equal to or more than the applicable designated percentage below the prevailing best bid in the applicable spread as reflected by any pending opposite side spread orders and the Implied Spread Bid for that spread. An Implied Spread Offer and an Implied Spread Bid are implied values for a spread based upon prices of the individual legs of the spread.

CFE currently designates a single limit order price reasonability percentage under Rule 513A(d) for each CFE Futures product. CFE had initially planned to take this same approach for each Options product. CFE now plans to designate a scale of different limit order price reasonability percentages for each Options product. Under this approach for Options, CFE plans to specify a number of price ranges for the limit price of a limit order and to apply a different price reasonability percentage for each price range. CFE is taking this approach for Options given the potential wide variation in prices across different Options series in the same Options product, including across Options series with the same expiration date because of their different exercise prices. For example, Options prices can be very low if an Option has an exercise price that is far out-of-the money close to its expiration and can be much higher when an Option has an exercise price that is deep in-the-money close to its expiration. This is in contrast to Futures which do not have different exercise prices and are priced in relation to the anticipated future value of the underlying of the Future. In light of the nature of Options pricing, the optimal price reasonability percentage for Options can vary across different price ranges and it may be optimal to have higher price reasonability percentages at lower option price levels and to have lower price reasonability percentages at higher option price levels.

Because the Exchange will have additional flexibility to set more granular price reasonability percentages by price range for an Options product and given the additional complexity involved in having Clearing Firms and TPHs also set different price ranges and/or different price reasonability percentages for each price range for an Options product, the Amendment revises Rule 513A(d) as amended by CFE-2023-002 to remove reference to Clearing Firms and TPHs having the ability to designate limit order price reasonability percentage parameters by EFID and Options product. Instead, only the Exchange will set limit order price reasonability percentage parameters for each Options product. Clearing Firms and TPHs will continue to have the ability to designate limit order price reasonability percentage parameters by EFID and Futures product.

<u>Execution Percentage of Contracts Outstanding Risk Control</u>

Second, CFE is modifying the description of the risk control under Rule 513A(j) (Options Risk Monitor Mechanism) as amended by CFE-2022-002 that is based upon the number of Options contracts executed as a percentage of the number of Options contracts outstanding. The updates to Rule 513A(j) further describe how this risk control functions.

As amended by CFE-2023-002, Rule 513A(j) provides that TPHs shall have the ability to designate parameters by EFID and Options product for, among other things, the number of contracts executed as a percentage of number of contracts outstanding within an Exchange-designated time period or during a trading day, as applicable. Rule 513A(j) provides that the CFE's trading system ("CFE System") determines this percentage by calculating the percentage of outstanding contracts that executed on each side of the market during the time period or trading day, as applicable, and then summing the series percentages on each side of the market.

The Amendment updates the description of this risk control to indicate that the calculation of the percentage of outstanding contracts executed on each side of the market is performed with respect to each order on that side of the market that is executed during the applicable time frame. Those individual order execution percentages are then added together to determine the total execution percentage during the applicable time frame. Additionally, the Amendment updates the description of this risk control to indicate that the percentage of execution of an order at any given time is measured in relation to the size of the order most recently designated by the TPH that submitted the order in an initial order or quote submission, a cancel replace/modify order or a replacement quote (regardless of any changes to the size of the order due to partial executions of the order).

Cancel Replace/Modify Orders

In connection with considering how to further describe the risk control relating to the execution percentage of contracts outstanding for Options, CFE had occasion to review the description in subparagraph (ii) of Rule 406(d) (Cancel Replace/Modify Orders and Quotes) regarding how a cancel replace/modify order functions when the original order has been partially executed. Based on that review, CFE is taking this opportunity to update Rule 406(d)(ii) to further clarify how cancel replace/modify orders for both Options and Futures function when the original order has been partially executed.

In particular, CFE is further clarifying the description in Rule 406(d)(ii) by revising it to provide that if a cancel replace/modify order is submitted to cancel and replace an existing order that has been partially executed, the CFE System decreases the current size of that order by the difference between the previously designated order size and the replacement order size designated by the cancel replace/modify order. CFE is also revising the description to further clarify that, for this purpose, the previously designated order size refers to the order size designated by the original order submission if the order size has not been previously modified by a cancel replace/modify order and refers to the most recently designated replacement order size if the order size has been previously modified by a cancel replace/modify order. Finally, the revised language of Rule 406(d)(ii) makes clear that if the decreased size of the existing order would be zero or less than zero, the existing order is canceled by the CFE System and the replacement order is rejected or canceled back to the sender by the CFE System.

The manner in which a cancel replace/modify order functions under Rule 406(d)(ii) when the original order has been partially executed does not impact the size of an order that is used in determining the percentage of execution of an order for purposes of the risk control relating to the execution percentage of contracts outstanding for Options. In particular, if a cancel replace/modify order is submitted to cancel and replace an existing order that has been partially executed (and as a result the CFE System decreases the current size of that order by the difference between the previously designated order size and the replacement order size in accordance with Rule 406(d)(ii)), the percentage of subsequent execution for the modified order is measured in relation to the

replacement order size designated by the cancel replace/modify order for purposes of that risk control and not in relation to the decreased order size to pursuant to Rule 406(d)(ii).

<u>Statutory Basis</u>

CFE believes that the Amendment is consistent with the Designated Contract Market ("DCM") Core Principles under Section 5 of the Act. In particular, CFE believes that the Amendment is consistent with: (i) DCM Core Principle 4 (Prevention of Market Disruption) in that taking an approach which allows for the Exchange to designate a different price reasonability percentage by price range for each Option product and making available to TPHs a risk control based upon the number of Options contracts executed as a percentage of the number of Options contracts outstanding reduces the potential risk of price distortions and market disruptions in Options offered for trading on CFE; (ii) DCM Core Principle 7 (Availability of General Information) because the Amendment specifies how CFE's limit order price reasonability check risk control functions in relation to Options, further describes the manner of operation of CFE's risk control for TPHs that is based upon the number of Options contracts executed as a percentage of the number of Options contracts outstanding, and further clarifies how cancel replace/modify orders for Options and Futures function when the original order has been partially executed; and (iii) DCM Core Principle 11 (Financial Integrity of Transactions) because CFE's limit order price reasonability check risk control contributes to the management by Clearing Members of their financial risk in relation to the Options trading activity of the TPHs for which they act as a Clearing Member.

CFE believes that the impact of the Amendment will be beneficial to the public and market participants. CFE is not aware of any substantive opposing views to the Amendment. CFE hereby certifies that the Amendment complies with the Act and the regulations thereunder. CFE further certifies that CFE has posted a notice of pending certification with the Commission and a copy of this submission on CFE's website (http://www.cboe.com/us/futures/regulation/rule_filings/cfe/) concurrent with the filing of this submission with the Commission.

<u>Contact Information</u>

Questions regarding this submission may be directed to Arthur Reinstein at (312) 786-7570 and Shane Wilkerson at (484) 798-9350. Please reference our submission number CFE-2023-007 in any related correspondence.

Cboe Futures Exchange, LLC

/s/ Laura Fuson

By: Laura Fuson
        Managing Director

EXHIBIT 1

The Amendment is to CFE's rules as amended by CFE Rule Certification Submission Number CFE-2023-002. The Amendment, marked to show additions in underlined text and deletions in ~~stricken~~ text, consists of the following:

Cboe Futures Exchange, LLC Rules

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406. Execution of Orders by CFE System

(a) - (c)   No changes.

(d)   *Cancel Replace/Modify Orders and Quotes*.

     (i)   No changes.

     (ii)   If ~~the expected size of an existing Order designated within~~ a Cancel Replace/Modify Order is submitted to cancel and replace an ~~that~~ existing Order ~~does not match the actual size of the existing Order~~ that has been partially executed, the CFE System decreases the current size of ~~the replacement~~ that Order by the difference between ~~the designated expected size of the existing Order and the actual size of the existing Order~~ the previously designated Order size and the replacement Order size designated by the Cancel Replace/Modify Order. For this purpose, the previously designated Order size refers to the Order size designated by the original Order submission if the Order size has not been previously modified by a Cancel Replace/Modify Order and refers to the most recently designated replacement Order size if the Order size has been previously modified by a Cancel Replace/Modify Order. If the decreased size of the ~~replacement~~ existing Order would be zero or less than zero, the existing Order is canceled by the CFE System and the replacement Order is rejected or canceled back to the sender by the CFE System.

     (iii)   No changes.

(e) - (h)   No changes.

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513A. Risk Controls

(a) - (c)   No changes.

(d)   *Futures and Options Limit Order Price Reasonability Checks*.

     (i)   The Exchange shall designate Limit Order price reasonability percentage parameters by product for Futures and Options products, and those percentages shall be set forth in the rules governing the applicable product. Clearing Members and Trading Privilege Holders shall have the ability to designate Limit Order price reasonability percentage parameters by EFID and product for Futures products. The most restrictive applicable Limit Order price reasonability percentage

that is designated shall apply.

(ii)   The Limit Order price reasonability checks under this Rule 513A(d) apply to simple Orders in Futures and Options products, other than to simple buy Orders when there is no prevailing offer and to simple sell Orders when there is no prevailing bid. For simple Orders in Futures and Options products, the CFE System shall reject or cancel back to the sender:

(A)   any buy Order with a limit price if the limit price upon receipt of the Order by the CFE System is equal to or more than the applicable designated percentage above the prevailing best offer in the applicable Contract; and

(B)   any sell Order with a limit price if the limit price upon receipt of the Order by the CFE System is equal to or more than the applicable designated percentage below the prevailing best bid in the applicable Contract.

(iii)   The Limit Order price reasonability checks under this Rule 513A(d) apply to Spread Orders in Options products and do not apply to Spread Orders in Futures products. For Spread Orders in Options products, the CFE System shall reject or cancel back to the sender:

(A)   any buy Order with a limit price if the limit price upon receipt of the Order by the CFE System is equal to or more than the applicable designated percentage above the prevailing best offer in the applicable spread as reflected by any pending opposite side Spread Orders and the Implied Spread Offer for that spread; and

(B)   any sell Order with a limit price if the limit price upon receipt of the Order by the CFE System is equal to or more than the applicable designated percentage below the prevailing best bid in the applicable spread as reflected by any pending opposite side Spread Orders and the Implied Spread Bid for that spread.

(iv)   The Limit Order price reasonability checks under this Rule 513A(d):

(A)   apply during Trading Hours;

(B)   do not apply prior to the opening or restart of trading in a Contract or during the opening or re-opening process for a Contract pursuant to Rule 405A;

(C)   apply to a Stop Limit Order when it is triggered (i.e., when the relevant Contract trades at the specified trigger price as described in Rule 404(a)(iv)) and not when a Stop Limit Order is received by the CFE System;

(D)   do not apply to Trade at Settlement Orders; and

(E)   do not apply to Block Trades and Exchange of Contract for Related Position transactions.

(e) - (i)   No changes.

(j)   *Options Risk Monitor Mechanism.*

(i)   Trading Privilege Holders shall have the ability to designate the following Options risk monitor mechanism parameters by EFID and Options product:

(A)   number of contracts executed ("volume");

(B)   notional value of executions ("notional"), which the CFE System calculates for purposes of the Options risk monitor mechanism by multiplying the number of contracts executed by the Options Premium to determine the notional value of each Options execution;

(C)   number of executions ("count"); and

(D)   number of contracts executed as a percentage of number of contracts outstanding within an Exchange-designated time period or during a trading day, as applicable ("percentage"), which the CFE System determines for purposes of the Options risk monitor mechanism by calculating the percentage of outstanding contracts of each Order that executed on each side of the market during the time period or trading day, as applicable, and then summing the series percentages on each side of the market. The percentage of execution of an Order at any given time is measured in relation to the size of the Order most recently designated by the Trading Privilege Holder that submitted the Order in an initial Order or Quote submission, a Cancel Replace/Modify Order or a replacement Quote (regardless of any changes to the size of the Order due to partial executions of the Order).

(ii)   Trading Privilege Holders may establish Options risk monitor mechanism parameters over a time period established by the Trading Privilege Holder(ii) ("interval limit") and on an absolute basis for a trading day ("absolute limit").

(iii)   Clearing Members shall have the ability to designate absolute notional limits by EFID and Options product. In the case of absolute notional limits by EFID and Options product, the most restrictive applicable limit that is designated by a Clearing Member and Trading Privilege Holder shall apply.

(iv)   When the CFE System determines that a volume, notional, count, or percentage limit designated by a Trading Privilege Holder or a Clearing Member has been reached within an interval or absolute limit for an EFID and Options product, the CFE System will trigger the Options risk monitor mechanism which cancels all Orders residing in the CFE System for the applicable EFID and Options product and rejects or cancels back to the sender any new Orders for the applicable EFID and Options product until the counting program resets.

(v)   If an Options risk monitor mechanism limit is reached during the opening or re-opening process for a Contract pursuant to Rule 405A, the Options risk monitor mechanism will not be triggered until the opening or re-opening process for that Contract is completed.

(vi)   The CFE System will execute any marketable Orders that are executable against a Trading Privilege Holder's Order received prior to the time that the Options risk monitor mechanism limit is triggered up to the size of the Trading Privilege Holder's Order, even if those executions result in executions in excess of the applicable Options risk monitor mechanism parameters.

(vii)   The CFE System will not accept new Orders from a Trading Privilege Holder after a volume, notional, count, or percentage limit designated by a Trading Privilege Holder has been reached within an interval or absolute limit for an EFID and Options product. This block on the acceptance of new Orders shall remain in place until the earlier of the end of the Business Day on which the block is activated or when the Trading Privilege Holder submits an electronic instruction to the CFE System to reset the count for the applicable limit in a form and manner prescribed by the Exchange.

(viii)   The CFE System will not accept new Orders from a Trading Privilege Holder after an absolute notional count limit designated by a Clearing Member has been reached for an EFID and Options product. This block on the acceptance of new Orders shall remain in place until the earlier of the end of the Business Day on which the block is activated or until the Trade Desk resets the count for the applicable limit after receiving a request from the Clearing Member to do so.

(ix)   The Exchange may limit the number of Options risk monitor mechanism resets submitted to the CFE System by a Trading Privilege Holder or Clearing Member over a designated period of time. The Exchange shall disseminate to Trading Privilege Holders and Clearing Members in a form and manner determined by the Exchange any limitation on the submission of Options risk monitor mechanism resets.

(x)   The CFE System will reset the counting period for an absolute limit designated by a Trading Privilege Holder or Clearing Member when the Trading Privilege Holder or Clearing Member that set the absolute limit refreshes its threshold for the absolute limit.

(xi)   The CFE System will reset the counting program and commence a new interval time period when:

(A)   a previous interval time period has expired and a transaction occurs in any series of the applicable Options product; or

(B)   a Trading Privilege Holder refreshes its risk limit threshold for an interval limit prior to the expiration of the interval time period.

(xii)   The CFE System counts individual trades executed as part of a Spread Order when determining whether a volume, notional, or count limit has been reached. The CFE System counts the percentage executed of a Spread Order when determining whether the percentage limit has been reached.

(k) - (o)   No changes.

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