Invested in America

August 31, 2020

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street NE., Washington, DC 20549

**Re: Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Amend the Options Regulatory Fee (File No. SR-CBOE-2020-069)**

Dear Ms. Countryman:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the above-referenced proposed rule change filed by Cboe Exchange, Inc. (the "Exchange" or "Cboe Options") with the Securities and Exchange Commission ("Commission") under Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act").[2] In the Proposal, Cboe Options is reducing the Options Regulatory Fee ("ORF") charged by the Exchange from $0.0045 per contract to $0.0023 per contract, effective August 3, 2020, in order to help ensure that revenue collected from the ORF, in combination with other regulatory fees and fines, does not exceed the Exchange's total regulatory costs. SIFMA notes that Cboe Options' exchange affiliates, Cboe BZX and Cboe C2, filed similar rule changes to reduce the ORF charged by them and that SIFMA's comments below on Cboe Options' ORF rule change apply equally to those two ORF rule changes filed by Cboe BZX and Cboe C2.[3]

## I. The Proposed Rule Change

As noted, Cboe Options proposes to reduce its ORF from $0.0045 per contract to $0.0023 per contract. In the Proposal, the Exchange notes that the ORF is assessed on each member for all transactions that clear in the customer range (i.e., customer transactions) at The Options Clearing Corporation ("OCC"), regardless of the exchange on which the transaction occurs and

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[1] SIFMA is the leading trade association for broker-dealers, investment banks, and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] See Exchange Act Release No. 89469 (August 4, 2020), 85 FR 48306 (August 10, 2020) ("Proposal").

[3] See Exchange Act Release No. 89471 (August 4, 2020), 85 FR 49405 (August 13, 2020) (File No. SR-CboeBZX-2020-057); Exchange Act Release No. 89470 (August 4, 2020), 85 FR 48312 (August 10, 2020) (File No. SR-C2-2020-008).

regardless of whether the firm clearing the trade is a Cboe Options member. Cboe Options also notes revenue generated from the ORF, when combined with all of the Exchange's other regulatory fees and fines, is designed to recover a material portion of the regulatory costs to the Exchange of the supervision and regulation of members' customer options businesses including performing routine surveillances, investigations, examinations, financial monitoring, and policy, rulemaking, interpretive, and enforcement activities. Cboe Options further notes that regulatory costs include direct regulatory expenses and certain indirect expenses for work allocated in support of the regulatory function. It provides a breakdown of direct regulatory expenses (74%) and indirect regulatory expenses (26%) as a percentage of overall regulatory costs. In addition, Cboe Options notes that it is the Exchange's practice that revenue generated from ORF not exceed more than 75% of total annual regulatory costs.

Cboe Options further notes in its Proposal that as a result of its semi-annual review of the amount of ORF revenue to be collected versus its regulatory expenses, it had determined to reduce by almost half the ORF it charges on customer transactions. The Exchange notes that record-high monthly options volumes in 2020, particularly since the COVID-19 pandemic started having impacts on the markets in March, coupled with lower regulatory costs led the Exchange to lower the ORF. The Exchange further notes in the filing that "when coupled with the Exchange's other regulatory fees and revenues, the Exchange estimates [its current] ORF to generate over 100% of the Exchange's projected regulatory costs."[4]

Significantly, the Exchange notes in the filing that notwithstanding the excess ORF revenue collected as of the filing date, it has not used such revenue for nonregulatory purposes consistent with the requirement in its Rule 2.2. The Exchange further states that "in connection with proposed ORF rate changes, it provides the Commission confidential details regarding the Exchange's projected regulatory revenue, including projected revenue from ORF, along with a breakout of its projected regulatory expenses, including both direct and indirect allocations."[5]

## II. Prior SIFMA Positions on the ORF

SIFMA and its member firms have long been concerned about the ORF fee collection practices of all of the options exchanges since the fee was first implemented by Cboe Options in 2009 and subsequently adopted by the other options exchanges over the years.[6] These concerns have generally focused on the confusion faced by customers and firms related to the ORF

[4] Proposal at 48308.

[5] Proposal at 48307.

[6] See, e.g., Letter from Ellen Greene, Managing Director, SIFMA, to Venessa Countryman, Secretary, Commission, dated August 27, 2019 (https://www.sec.gov/comments/sr-nyseamer-2019-27/srnyseamer201927-6032478-191228.pdf); Letter from Ellen Greene, Managing Director, SIFMA, to Venessa Countryman, Acting Secretary, Commission, dated April 10, 2019 (https://www.sec.gov/comments/sr-emerald-2019-01/sremerald201901-5343269-184039.pdf); and Letter from Ellen Greene, Managing Director, SIFMA, to Brent Fields, Secretary, Commission, dated September 13, 2017 (https://www.sec.gov/comments/sr-phlx-2017-54/phlx201754-2442743-161060.pdf).

charges as well as the lack of transparency related to the determination of the level of ORF rates and the use of the ORF revenue by exchanges.

On the confusion front, SIFMA notes there are currently three different models for assessing the ORF on customer transactions among the exchange groups. The model employed by Cboe, which is described above, is followed by three of its affiliate options exchanges, the BOX Options exchange, and the three MIAX options exchanges. Exchanges following this model assesses an ORF charge on all customer transactions regardless of the exchange on which they occur and regardless of whether the firm clearing the transaction is member of the exchange assessing the ORF. The NYSE has its own model that each of its two options exchanges follow. This model assesses an ORF charge on all customer transactions effected by its members, including ones effected on away exchanges, but excludes trades cleared by non-members, including ones executed on an NYSE exchange. The third model is the model followed by Nasdaq for its six options exchanges. This model assesses an ORF charge on all customer transactions effected by its members, including trades effected on away exchanges, but excludes trades executed on away exchanges cleared by non-members. Unlike the NYSE model, Nasdaq's model assesses an ORF charge on all customer transactions executed on a Nasdaq exchange and cleared by non-members. The impact of these three different models on customers and firms is that the same options trade executed by a firm for a customer could result in up to three different ORF assessments depending on which exchange(s) the trade was executed.

In addition to the complexity of having to grapple with three different models for assessing the ORF charges, both customers and firms must deal with different ORF rates among the individual exchanges. For instance, Cboe Options' ORF rate is now $.0023 per contract after this Proposal, whereas the BOX Options' ORF rate is $.0038 per contract and the Miami International Securities Exchange's ORF rate is $.0029 per contract. Coupled with the three different ORF assessment methodologies noted above, these different ORF rates among the individual exchanges makes it very difficult for customers and firms to predict how much in ORF charges a particular option transaction will have. It also places firms in the awkward position of having to try to explain to their customers why an options transaction executed on one exchange has a different ORF charge amount than the same options transaction executed on another exchange. Moreover, because the exchanges charge different and overlapping ORF rates and use different ORF assessment methodologies for the same transaction, it is especially difficult for firms to calculate how much in ORF charges should be passed through to customers on their options trades. In addition, the monthly invoices that clearing firms receive from OCC are not helpful because they just show a flat dollar amount that the firm owes to each exchange. The exchanges have acknowledged that they do not break out the customer transactions that the firm executed on away exchanges since they do not have the data. This makes it extremely difficult for firms to reconcile their ORF invoices since there are no details provided to allow them to compare what they believe they owe an exchange in ORF charges versus what the exchange is charging them.

On the transparency front, SIFMA notes that exchanges historically have provided very little public details regarding how they determine the level of their ORF rates. For example, the exchanges' rule filings with the SEC to establish and change the ORF rates do not provide a dollar breakdown of the exchanges' regulatory costs or how the planned ORF rates will cover those costs. [7] Similarly, exchanges have not publicly provided, other than at a high-level, details on the actual regulatory functions that the exchanges use the ORF revenue to fund, and no exchange has publicly provided the costs of those functions. The exchanges' Form 1 filed with the SEC are not helpful in this regard.[8] SIFMA believes that greater transparency is especially important now as the exchanges have moved to for-profit models and many of the options exchanges are part of larger holding company structures in which the parent holding company is listed and publicly traded.

SIFMA has noted, for instance, that the way the ORF is implemented at certain exchange families appears to allow such an exchange family to launch a new options exchange without having any out-of-pocket costs for the regulatory expenses of the new exchange once it launches in production. In other words, a newly formed exchange at such an exchange family can start collecting ORF revenue on customer options transactions without having executed a single trade. These newly formed exchanges often have very little market share but can charge an ORF similar to that of an exchange with substantial market share. It is also possible that an exchange may be able to launch other commercial endeavors if they can somehow point to some of the costs associated with those endeavors as being regulatory in nature. The current lack of public transparency regarding exchanges' determination of the level of ORF rates and exchanges' use of the ORF revenue makes these scenarios possible or at least plausible to believe without real details.

## III. Discussion

### A. Cboe Options ORF Filing

SIFMA commends Cboe Options for this rule change to lower the ORF rate at the Exchange. As the Exchange notes in Proposal, options exchange volumes have exploded since the initial impacts of the COVID-19 pandemic started being felt by the markets in March 2020. OCC's recent August 4, 2020 press release notes that July 2020 options volume was 52.5% higher than July 2019 volume, with July 2020 being the highest July monthly volume ever, and

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[7] See, e.g., Exchange Act Release No. 85162 (February 15, 2019), 84 FR 5783 (February 22, 2019) (File No. SR-MIAX-2019-01).

[8] A few exchanges such as Cboe Options provide on their Form 1s gross amounts of ORF revenue collected in a year but there are no breakouts of regulatory expense amounts or the cost of the regulatory functions that make up those expenses.

that year-to-date options volume is 47.4% higher than the same period in 2019.[9] Similarly, Cboe Options notes in its Proposal that June 2020 volume was the highest options volume month in the history of the U.S. options markets and that total customer options contract volume in April 2020 was 50.27% higher than total customer volume in April 2019 and total customer options contract volume in May 2020, was 29.10% higher than total customer volume in May 2019.[10] This volume increase has resulted in a significant increase in the amount of ORF revenue collected by the options exchanges, with Cboe Options noting in its Proposal that the current ORF rate at the Exchange prior to the rule change coupled with the other regulatory fees collected by the Exchange would cover more than 100% of the Exchange's projected regulatory costs.

Given the record options volumes and the resulting increases in the amount of ORF revenue collected by exchanges, as well as the fact that ORF rates have not been lowered recently, SIFMA believes that it is appropriate for Cboe Options and its options exchange affiliates to lower their ORF rates. SIFMA also strongly believes that it is appropriate for the other options exchanges to follow Cboe Options' lead and reduce their ORF rates given the significant increase in options volume this year as compared with 2019. In making these comments, SIFMA is not taking a position on whether Cboe Options' Proposal complies with the Exchange Act requirements for fee filings and the Commission staff's May 2019 guidance regarding those requirements.[11] The Commission as the regulator of national securities exchanges is the one that ultimately makes this determination. Nonetheless, SIFMA member firms support the Proposal's fee decrease.

In addition to the reduction in the ORF rate at Cboe Options and its options exchange affiliates, SIFMA applauds the Exchange for its practice to limit ORF revenue to no more than 75% of the Exchange's regulatory costs. In making this comment, SIFMA is presuming that the Exchange's reference to regulatory costs refers to the costs associated with the regulation of members' customer options businesses, which is what the ORF charge is designed to cover, as opposed to the Exchange's entire regulatory costs. SIFMA notes that each options exchange assessing the ORF has stated that the fee is designed to cover a material portion of the exchange's regulatory costs associated with members' customer options business.[12] Other than Cboe Options and its options exchange affiliates, SIFMA is not aware of another options exchange that has an actual percentage limit on the amount of regulatory costs the ORF is designated to cover. SIFMA believes that Cboe Options and its affiliates' approach of placing an actual limit is the right one and should be followed by the other options exchanges. In making this comment, SIFMA also notes that it is not taking a position on whether 75% is the right

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[9] See (https://www.theocc.com/Newsroom/Press-Releases/2020/08-03-OCC-July-2020-Total-Volume-Up-52-5-Percent-f).

[10] Proposal at 48307.

[11] See (https://www.sec.gov/tm/staff-guidance-sro-rule-filings-fees).

[12] See supra note 7.

number but is deferring to the Commission as the regulator of national securities exchanges to review the numbers used by the options exchanges.

SIFMA believes that one of the ways for the Commission to address this issue with regard to all of the options exchanges is to ensure that existing and new options exchanges and their exchange families adhere to the standard set forth in their rule filings that ORF revenue cover a material portion (i.e., not all) of the regulatory costs of the exchange for their members' customer options businesses. SIFMA believes that like Cboe Options and its options exchange affiliates, the other options exchanges should be required to demonstrate that they rely on other regulatory fees and revenue besides ORF revenue to fund their regulatory programs. For example, such a practice would force exchange families to fund part of the start-up regulatory costs of a new exchange out of their own pockets since presumably these other regulatory fees, such as fines, would not be available on day one of the start of operations of the new exchange, unlike ORF revenue. As it stands right now, it appears as if exchange families could have no regulatory costs associated with starting a new options exchange, as such costs could be covered entirely by the ORF revenue collected by the new exchange. This is not how SIFMA understands it works in the equities markets, where exchange families must initially fund regulatory costs out their own pockets in connection with launching a new exchange. SIFMA believes that like the equity markets, this regulatory "skin in the game" approach also should apply to the launch of new options exchanges.

SIFMA also applauds Cboe Options for the requirement in its rules that regulatory revenue such as ORF revenue only be used to fund regulatory costs of the Exchange. In particular, Cboe Options Rule 2.2 provides in relevant part that the Exchange, "may not use any revenues it receives from fees derived from its regulatory function or regulatory fines for nonregulatory purposes, but rather must use them to fund the legal and regulatory operations of the Exchange (including surveillance and enforcement activities), or, as the case may be, to pay restitution and disgorgement of funds intended for customers." SIFMA believes that this approach by Cboe Options is the right one and that regulatory revenue should be used by exchanges to fund only regulatory functions. To the extent that the other options exchanges do not have such a rule in place, SIFMA believes that they should adopt one to make it clear to the public that ORF revenue and other regulatory revenue collected by the exchanges is being used to fund only the regulatory functions of the exchanges.[13]

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[13] SIFMA notes that based on a high-level survey of the rules of the other options exchanges, besides Cboe Options and its options exchange affiliates, the NYSE options exchanges appear to be the only other exchanges with such a rule in place. For instance, Section 2.03(b) of the NYSE Arca Bylaws provides that, "[a]ny regulatory assets or any regulatory fees, fines or penalties collected by the Exchange's regulatory staff will be applied to fund the legal, regulatory and surveillance operations of the Exchange, and the Exchange shall not distribute such assets, fees, fines or penalties to pay dividends or be distributed to any other entity. For purposes of this Section, regulatory penalties shall include restitution and disgorgement of funds intended for customers." SIFMA is reading this provision as allowing the exchange to use regulatory revenue to cover only regulatory expenses and not any other expenses.

SIFMA believes that such a rule should be adopted swiftly by the options exchange that do not have one in place yet. SIFMA recently conducted a survey of its member firms to get a sense of how much in ORF charges the firms had paid in the first four months of 2020 (i.e., January to April 2020) to the options exchanges. Based on the results from the eight firms that responded, which SIFMA believes represent a majority of firms with significant customer options businesses, SIFMA found that some of the smaller exchange groups as defined by market share collected as much or more in ORF revenue than the larger exchange groups as defined by market share over this time period. SIFMA believes that it seems implausible based on what SIFMA understands about the regulation of the options market that these smaller exchange groups have regulatory costs equal to or in excess of the larger exchange groups.[14] This is why SIFMA believes it is so important for the options exchange to immediately adopt a rule modeled on Cboe Options Rule 2.2 if they do not already have one.

**B. Future Improvements to ORF Practices**

SIFMA notes that the information Cboe Options provides in the Proposal regarding the determination of the ORF rate and the use of ORF revenue generally is more than the information provided by other exchanges in connection with their ORF rule filings. In its Proposal, Cboe Options describes at a high-level the category of regulatory functions that it uses the ORF revenue to fund. It also provides a high-level breakout of the direct and indirect regulatory costs as a percentage of overall regulatory costs incurred by the Exchange. In addition, Cboe Options notes in its filing that it has provided certain confidential information to the Commission regarding its projected regulatory revenues, including ORF revenue, as well as a projected breakout of direct and indirect regulatory expenses.

As noted above, however, SIFMA believes that perhaps the biggest issue related to the ORF practices of the options exchanges is the lack of detail regarding how the exchanges determine their ORF rates as well as the regulatory functions and the costs of those functions they use the ORF revenue to cover. In the future, SIFMA believes that the Commission should consider in connection with ORF filings ways to enhance the information provided by the options exchanges with the ultimate goal of having the exchanges provide actual breakouts in dollar amounts of the ORF revenue collected as well as the regulatory functions and the costs of those functions the ORF revenue is used to cover. Such breakouts should be designed to provide enough detail to allow market participants to have a reasonable picture of the regulatory functions that the exchanges use ORF revenue to fund as well as the costs of those functions. The Commission could consider its 2004 proposed amendments to Form 1 as a reference point in connection with determining the level of detail that options exchanges provide regarding the

[14] SIFMA also questions what exchange groups are doing with the excess ORF revenue to the extent that it exceeds their costs of regulating members' customer options businesses.

amount of ORF revenue collected as well the regulatory functions and their associated costs that the ORF revenue is used to fund.[15]

SIFMA fails to understand why there would be objections to exchanges providing more public detail regarding their regulatory costs as such costs does not seem to be an area of competitive concern among the exchanges. Furthermore, this current lack of detail on such costs does not allow market participants and the public the ability to judge whether an exchange's regulatory costs are appropriate. In fact, this lack of transparency could be fostering a scenario in which there is no incentive among the options exchanges to control their regulatory costs. SIFMA understands that many of the regulatory functions of the options exchanges have been outsourced to FINRA.[16] It would seem that there should be certain efficiencies that could be gained from a regulatory cost perspective by having a single provider such as FINRA provide the same regulatory services to multiple exchanges. SIFMA's recent ORF survey of its members noted above, however, suggests the opposite. Rather than resulting in reductions in exchanges' regulatory costs, it appears that exchanges' regulatory costs are ballooning. Without further transparency into these costs, market participants have no way of understanding whether exchanges' regulatory costs as well as the costs of FINRA's services are appropriate.

As the Commission considers ORF practices of the options exchanges in the future, SIFMA believes the exchanges and the Commission also should consider whether it makes sense to have a single model for assessing the ORF among the options exchange groups. Right now, customer and firms must deal with the complexity and confusion created by the use of three different ORF assessment models. While SIFMA is not taking a position on which model should be favored, SIFMA does believe that the use of one assessment model as opposed to three should help reduce this complexity and confusion.

Finally, SIFMA requests that the options exchange work with OCC to provide more detail to the OCC clearing firms regarding their ORF charges by exchange. At a minimum, firms should be able to request detail from each exchange on the customer transactions that were assessed an ORF by the exchange so that the firms can conduct a reconciliation of that data with their own data to make sure they are being assessed the proper amount of ORF charges. Currently, this level of transparency is lacking as the firms receive a bill each month that solely

[15] See Exchange Act Release No. 50699 (November 18, 2004), 69 FR 71125 (December 8, 2004). In this release, the Commission proposed among other things amendments to Form 1 that would require exchanges to provide detailed disclosure regarding the portion of their overall revenues devoted to regulatory expenses as well as a break-down of those expenses.

[16] In September 2017, the CEO of FINRA noted in a speech that FINRA had entered into Regulatory Services Agreements with 19 exchanges that operate 26 stock and options markets at the time of his speech. FINRA's CEO further noted that through these agreements, and in coordination with the exchanges, FINRA's surveillance canvassed 99.5 percent of U.S. stock market trading volume and about 65 percent of U.S. options trading activity. See Speech by Robert Cook, President and CEO, FINRA titled "Equity Market Surveillance Today and the Path Ahead" dated September 20, 2017 (https://www.finra.org/media-center/speeches-testimony/equity-market-surveillance-today-and-path-ahead).

indicates the dollar amount of ORF charges the firm owes to each exchange. Providing this additional detail would be a useful incremental improvement to the current ORF practices today.

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SIFMA greatly appreciates the Commission's consideration of the issues raised above and would be pleased to discuss these comments in greater detail. If you have any questions or need any additional information, please contact me (at 212-313-1287 or egreene@sifma.org).

Sincerely,

Elle Greene

Ellen Greene
Managing Director
Equities & Options Market Structure

cc: The Honorable Jay Clayton, Chairman
The Honorable Hester M. Peirce, Commissioner
The Honorable Elad L. Roisman, Commissioner
The Honorable Allison Herren Lee, Commissioner

Brett Redfearn, Director, Division of Trading and Markets