

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–84311; File No. SR–Phlx–2018–55]

Self-Regulatory Organizations; Nasdaq PHLX LLC; Order Approving a Proposed Rule Change Relating to Anticipatory Hedging

September 28, 2018.

I. Introduction

On August 3, 2018, Nasdaq PHLX LLC (“Exchange” or “Phlx”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”) ¹ and Rule 19b–4 thereunder, ² a proposed rule change amending Phlx’s Rule 1064(d), relating to anticipatory hedging of crossing, facilitation, and solicited orders. The proposed rule change was published for comment in the *Federal Register* on August 16, 2018. ³ The Commission received no comment letters on the proposed rule change. This order approves the proposed rule change.

II. Description of the Proposed Rule Change

The Exchange has proposed to amend Phlx Rule 1064(d), governing anticipatory hedging relating to crossing, facilitation, and solicitation orders. Specifically, the Exchange has proposed to lower the eligibility size for the “tied hedge” exception to the anticipatory hedging prohibition from 500 contracts to 50 contracts per order ⁴ for options on the Nasdaq 100 Index, including options with nonstandard expiration dates (“NDX” and “NDXP”). ⁵ The tied hedge exception eligibility size for all other options orders will remain at 500 contracts per order. ⁶

Phlx Rule 1064(d) governing anticipatory hedging prohibits member organizations and associated persons of members and member organizations who have knowledge of the material terms and conditions of a solicited, facilitated, or crossed order that is to be imminently executed from entering, based on such knowledge, an order to

buy or sell the underlying security, an option for the same underlying security, or any related instrument ⁷ until certain conditions set forth in the rule are met. ⁸ Specifically, the order may only be entered when (i) the terms and conditions of the order and any changes in the terms of the order that the member, member organization, or associated person has knowledge of are disclosed to the trading crowd, or (ii) the trade can no longer reasonably be considered imminent in view of the passage of time since the order was received.

Phlx Rule 1064(d)(iii) sets forth an exception to this rule, known as the “tied hedge” exception. Under such exception, a member or member organization is not prohibited from buying or selling a stock, security futures, or future position following the receipt of an option order, including a complex order, but prior to announcing such order to the trading crowd, provided that the option order is in a class designated as eligible for “tied hedge” transactions, ⁹ as determined by the Exchange, and is within the designated tied hedge eligibility size parameters, also determined by the Exchange and which may not be smaller than 500 contracts per order. ¹⁰

The Exchange now proposes to lower the minimum tied hedge eligibility size threshold for NDX and NDXP, from 500 contracts to 50 contracts. The Exchange asserts that this smaller eligibility size for NDX and NDXP is appropriate because the index value for NDX and NDXP is high as compared to other securities instruments and would reduce the minimum notional value required for a trade to be eligible for the tied hedge exception.

The Exchange also proposes to amend Phlx Rule 1066 to delete the term “Phlx XL” and replace it with the term “System.” ¹¹ It also proposes to amend an incorrect cross-reference to the tied hedge exception, Commentary .04 to Phlx Rule 1064, and replace it with the

correct cross-reference, Rule 1064(d)(iii). ¹²

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act ¹³ and the rules and regulations thereunder applicable to a national securities exchange. ¹⁴ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act, ¹⁵ which requires 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 interest.

When adopting the tied-hedge exception, Phlx described the provision as a limited exception that remained in keeping with the original design of the anticipatory hedging prohibition, ¹⁶ while responding to increased trading in the over-the-counter market and changes in the marketplace that favored volatility trading strategies. ¹⁷ The Exchange explained that the primary purpose of the 500 contracts minimum eligibility size provision of the tied hedge exception was to limit the use of the tied hedge procedures to larger orders that might benefit from the member’s or member organization’s ability to execute a facilitating hedge. ¹⁸

¹² See Proposed Phlx Rule 1066(f)(4).

¹³ 15 U.S.C. 78f.

¹⁴ In approving this proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁵ 15 U.S.C. 78f(b)(5).

¹⁶ The Exchange stated that when it originally adopted the anticipatory hedging prohibition, it believed the prohibition was necessary to prevent members and associated persons from using undisclosed, non-public information about imminent solicited options transactions to trade in advance of persons represented in the options crowd. See Notice, *supra* note 3, at 40798. See also Securities Exchange Act Release No. 44740 (August 23, 2001), 66 FR 45721 (August 29, 2001) (SR–Phlx–2001–61).

¹⁷ See Securities Exchange Act Release No. 61066 (November 25, 2009), 74 FR 63162 (December 2, 2009) (SR–Phlx–2009–98).

¹⁸ *Id.*

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b–4.

³ See Securities Exchange Act Release No. 83826 (Aug. 10, 2018), 83 FR 40797 (“Notice”).

⁴ See Proposed Phlx Rule 1064(d)(iii)(A).

⁵ NDX represents A.M.-settled options on the Nasdaq 100[®] Index. NDXP represent P.M.-settled options on the Nasdaq 100[®] Index.

⁶ See Proposed Phlx Rule 1064(d)(iii)(A).

⁷ See Phlx Rule 1064(d)(ii), which states that an order to buy or sell a “related instrument” means, in reference to an index option, an order to buy or sell securities comprising 10% or more of the component securities in the index or an order to buy or sell a futures contract on an economically equivalent index.

⁸ See Phlx Rule 1064(d).

⁹ See Phlx Rule 1064(d)(iii)(C)–(H).

¹⁰ See Phlx Rule 1064(d)(iii)(A). The rule also provides that there shall be no aggregation of multiple orders to satisfy the size parameters.

¹¹ See Proposed Phlx Rule 1066. See also Phlx Rule 1000(b)(45) (defining “System”).

As noted above, the Exchange asserts that a lower tied hedge minimum eligibility size is appropriate for options on the Nasdaq 100 Index because the index value for NDX and NDXP is high compared to the index values of other security instruments, adding that a size of 50 contracts for NDX is still considered a large size order given NDX's higher notional value.¹⁹ To illustrate the high notional value of options on the Nasdaq 100 Index, Phlx stated that based on the index value, the multiplier, and the premium value, the current 500 minimum contract size parameter would require an NDX options transaction with a premium of approximately \$6.5 million in order to qualify for the rule's tied hedge exception.²⁰

The Commission believes that the reduced tied hedge eligibility size requirement of 50 contracts for options on the Nasdaq 100 Index is in line with the original intent of the provision, as it will continue to be limited to larger orders, given the relatively higher index value and notional value of NDX and NDXP.²¹ While the reduction in the minimum size requirement may allow more transactions to qualify for the tied hedge exception, the Commission believes that the proposed change is narrow in scope as it relates only to options in NDX and NDXP and will continue to provide only a limited exception for larger orders meeting the conditions of the rule.²²

The Commission also finds that the non-substantive changes to Phlx Rule 1066 are designed to protect investors and the public interest by adding clarity and transparency to the rules.

For the reasons noted above, the Commission finds that the proposed rule change is consistent with the Act.

¹⁹ See Notice, *supra* note 3, at 40798–99.

²⁰ See Notice, *supra* note 3, at 40798.

²¹ See Notice, *supra* note 3, at 40798–99. The Commission also notes that the Exchange represented that it conducts surveillance in connection with anticipatory hedging. Specifically, the Exchange represented that it conducts on-floor surveillance to ensure both the stock and option components of the trade were exposed in open outcry and that the trading crowd had a reasonable opportunity to participate in the transaction. The Exchange asserted that it also conducts post-trade surveillance. The Exchange also noted that prior to entering tied hedge orders on behalf of customers, the member or member organization must deliver to the customer a written notification informing the customer that his order may be executed using the Exchange's tied hedge procedures. See Phlx Rule 1064(d)(iii)(G).

²² The Commission notes that the Exchange represented that tied hedge transactions do not occur with great frequency on the Exchange's trading floor. *Id.*

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,²³ that the proposed rule change (SR–Phlx–2018–55) be, and hereby is, approved.

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

Eduardo A. Aleman,

Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–84320; File No. SR–IEX–2018–19]

Self-Regulatory Organizations; Investors Exchange LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Amend Rule 2.160 Related to the Qualification and Registration Requirements for Associated Persons of a Member and To Delete Rule 2.150 Which is Obsolete

September 28, 2018.

Pursuant to Section 19(b)(1)¹ of the Securities Exchange Act of 1934 (the “Act”)² and Rule 19b–4 thereunder,³ notice is hereby given that, on September 25, 2018, the Investors Exchange LLC (“IEX” or the “Exchange”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the self-regulatory organization. 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

Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 (“Act”),⁴ and Rule 19b–4 thereunder,⁵ IEX is filing with the Commission a proposed rule change to amend IEX Rule 2.160 to (i) harmonize IEX rules with certain Financial Industry Regulatory Authority, Inc. (“FINRA”) rules related to qualification and registration requirements for associated persons of a Member⁶ which

²³ 15 U.S.C. 78s(b)(2).

²⁴ 17 CFR 200.30–3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 15 U.S.C. 78a.

³ 17 CFR 240.19b–4.

⁴ 15 U.S.C. 78s(b)(1).

⁵ 17 CFR 240.19b–4.

⁶ “Person Associated with a Member” or “Associated Person of a Member” mean [sic] any

are pending effectiveness; (ii) specify when associated persons of a Member are required to be registered with the Exchange; and (iii) delete Rule 2.150 related to a temporary membership application process and waive-in, which is obsolete. The Exchange has designated this rule change as “non-controversial” under Section 19(b)(3)(A) of the Act⁷ and provided the Commission with the notice required by Rule 19b–4(f)(6) thereunder.⁸

The text of the proposed rule change is available at the Exchange's website at www.iextrading.com, at the principal office of the Exchange, and at the Commission's Public Reference Room.

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

In its filing with the Commission, the self-regulatory organization 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 [sic] may be examined at the places specified in Item IV below. The self-regulatory organization 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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange is proposing to amend Rule 2.160 to (i) harmonize with certain FINRA rules related to qualification and registration requirements for associated persons of a Member which are pending effectiveness; (ii) specify when associated persons of a Member are required to be registered with the Exchange; and (iii) delete Rule 2.150 related to a temporary membership application process and waive-in, which is obsolete. Each proposed change is described below.

partner, officer, director, or branch manager of a Member (or person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such Member, or any employee of such Member, except that any person associated with a Member whose functions are solely clerical or ministerial shall not be included in the meaning of such term for purposes of these Rules. See IEX Rule 1.160(y). See also 15 U.S.C. 78c(a)(18).

⁷ 15 U.S.C. 78s(b)(3)(A).

⁸ 17 CFR 240.19b–4.