

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-86437 File No. SR-NASDAQ-2019-053)

July 23, 2019

Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Amend Its Rules Governing the Nasdaq Options Market to Modify the Give Up of a Clearing Participant by a Participant on NOM transactions

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 July 9, 2019, The Nasdaq Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III, 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

The Exchange proposes to amend its rules governing the Nasdaq Options Market (“NOM”) to modify the give up of a Clearing Participant<sup>3</sup> by a Participant<sup>4</sup> on NOM transactions.

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

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

<sup>3</sup> The term “Clearing Participant” means a Participant that is self-clearing or a Participant that clears NOM Transactions for other Participants of NOM. See Chapter I, Section 1(a)(9).

<sup>4</sup> The term “Participant” means a firm, or organization that is registered with the Exchange pursuant to Chapter II of the Exchange’s rules for purposes of participating in options trading on NOM as a “Nasdaq Options Order Entry Firm” or “Nasdaq Options Market Maker.” See Chapter I, Section 1(a)(40).

The text of the proposed rule change is available on the Exchange's Website at <http://nasdaq.cchwallstreet.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 Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The Exchange proposes to amend its requirements in Chapter VI, Section 14 related to the give up of a Clearing Participant by a Participant on NOM transactions. This proposed rule change is substantially similar<sup>5</sup> to a recently-approved rule change by the Exchange's affiliate, Nasdaq PHLX LLC ("Phlx"),<sup>6</sup> and serves to align the rules of Phlx and the Exchange.<sup>7</sup>

By way of background, to enter transactions on NOM, a Participant must either be a Clearing Participant or must have a Clearing Participant agree to accept financial responsibility

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<sup>5</sup> Specifically, Nasdaq is not adopting section (c)(i) of Phlx Rule 1037, which relates to how the Phlx trading system will enforce unauthorized Give Ups for floor trades.

<sup>6</sup> See Securities Exchange Act Release No. 85136 (February 14, 2019) (SR-Phlx-2018-72) (Approval Order).

<sup>7</sup> The other Nasdaq, Inc.-owned options markets, Nasdaq BX, Nasdaq ISE, Nasdaq GEMX, and Nasdaq MRX (collectively, "Nasdaq HoldCo Exchanges"), have already filed or will file similar rule change proposals based on the Phlx filing.

for all of its transactions. In particular, Chapter VI, Section 14 currently provides that a Participant must give up the name of the Clearing Participant through which the transaction will be cleared. Chapter VI, Section 15(a) provides, in relevant part, that every Clearing Participant shall be responsible for the clearance of NOM transactions of such Clearing Participant and of each Participant that gives up such Clearing Participant's name pursuant to a letter of authorization, letter of guarantee or other authorization given by such Clearing Participant to such Participant, which authorization must be submitted to the Exchange. Additionally Chapter VII, Section 8 provides that no Participant shall make any transactions on NOM unless a Letter of Guarantee has been issued for such Participant by a Clearing Participant and filed with the Exchange.

Recently, certain Clearing Participants, in conjunction with the Securities Industry and Financial Markets Association ("SIFMA"), expressed concerns related to the process by which executing brokers on U.S. options exchanges ("Exchanges") are allowed to designate or 'give up' a clearing firm for purposes of clearing particular transactions. The SIFMA-affiliated Clearing Participants have recently identified the current give up process as a significant source of risk for clearing firms, and subsequently requested that the Exchanges alleviate this risk by amending Exchange rules governing the give up process.<sup>8</sup>

#### Proposed Rule Change

Based on the above, the Exchange now seeks to amend its rules regarding the current give up process in order to allow a Clearing Participant to opt in, at The Options Clearing Corporation ("OCC") clearing number level, to a feature that, if enabled by the Clearing Participant, will allow the Clearing Participant to specify which Participants are authorized to

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<sup>8</sup> See note 6 above.

give up that OCC clearing number. Accordingly, Section 14 will be retitled as “Authorization to Give Up,” and the current rule text will be replaced by new language. Specifically, proposed Section 14(a) will provide that for each transaction in which a Participant participates, the Participant may indicate, through post trade allocation, any OCC number of a Clearing Participant through which a transaction will be cleared (“Give Up”), provided the Clearing Participant has not elected to “Opt In,” as defined in paragraph (b) of the proposed Rule, and restrict one or more of its OCC number(s) (“Restricted OCC Number”).<sup>9</sup> A Participant may Give Up a Restricted OCC Number provided the Participant has written authorization as described in paragraph (b)(ii) (“Authorized Participant”).

Proposed Section 14(b) provides that Clearing Participants may request the Exchange restrict one or more of their OCC clearing numbers (“Opt In”) as described in subparagraph (i) of Section 14(b). If a Clearing Participant Opts In, the Exchange will require written authorization from the Clearing Participant permitting a Participant to Give Up a Clearing Participant’s Restricted OCC Number. An Opt In would remain in effect until the Clearing Participant terminates the Opt In as described in subparagraph (iii). If a Clearing Participant does not Opt In, that Clearing Participant’s OCC number may be subject to Give Up by any Participant.

Proposed Section 14(b)(i) will set forth the process by which a Clearing Participant may Opt In. Specifically, a Clearing Participant may Opt In by sending a completed “Clearing

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<sup>9</sup> Today, electronic trades need a valid mnemonic, which is only set up if there is a clearing arrangement already in place through a Letter of Guarantee. As such, electronic trades automatically clear through the guarantor associated with the mnemonic at the time of the trade, so a member organization may only amend its Give Up post-trade. As proposed, the Exchange will also restrict the post-trade allocation portion of an electronic trade systematically. See note 12 below.

Member Restriction Form” listing all Restricted OCC Numbers and Authorized Participant.<sup>10</sup> A copy of the proposed form is attached [sic] in Exhibit 3. A Clearing Participant may elect to restrict one or more OCC clearing numbers that are registered in its name at OCC. The Clearing Participant would be required to submit the Clearing Member Restriction Form to the Exchange’s Membership Department as described on the form. Once submitted, the Exchange requires ninety days before a Restricted OCC Number is effective within the System. This time period is to provide adequate time for the member users of that Restricted OCC Number who are not initially specified by the Clearing Participant as Authorized Participants to obtain the required written authorization from the Clearing Participant for that Restricted OCC Number. Such member users would still be able to Give Up that Restricted OCC Number during this ninety day period (i.e., until the number becomes restricted within the System).

Proposed Section 14(b)(ii) will set forth the process for Participants to Give Up a Clearing Participant’s Restricted OCC Number. Specifically, a Participant desiring to Give Up a Restricted OCC Number must become an Authorized Participant.<sup>11</sup> The Clearing Participant will be required to authorize a Participant as described in subparagraph (i) or (iii) of Section 14(b) (i.e., through a Clearing Member Restriction Form), unless the Restricted OCC Number is already subject to a Letter of Guarantee that the Participant is a party to, as set forth in Section 14(d).

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<sup>10</sup> This form will be available on the Exchange’s web site. The Exchange will also maintain, on its web site, a list of the Restricted OCC Numbers, which will be updated on a regular basis, and the Clearing Participant’s contact information to assist Participants (to the extent they are not already Authorized Participants) with requesting authorization for a Restricted OCC Number. The Exchange may utilize additional means to inform its members of such updates on a periodic basis.

<sup>11</sup> The Exchange will develop procedures for notifying Participants that they are authorized or unauthorized by Clearing Participants.

Pursuant to proposed Section 14(b)(iii), a Clearing Participant may amend the list of its Authorized Participants or Restricted OCC Numbers by submitting a new Clearing Member Restriction Form to the Exchange's Membership Department indicating the amendment as described on the form. Once a Restricted OCC Number is effective within the System pursuant to Section 14(b)(i), the Exchange may permit the Clearing Participant to authorize, or remove authorization for, a Participant to Give Up the Restricted OCC Number intra-day only in unusual circumstances, and on the next business day in all regular circumstances. The Exchange will promptly notify the Participants if they are no longer authorized to Give Up a Clearing Participant's Restricted OCC Number. If a Clearing Participant removes a Restricted OCC Number, any Participant may Give Up that OCC clearing number once the removal has become effective on or before the next business day.

Proposed Section 14(c) will provide that the System will not allow an unauthorized Give Up with a Restricted OCC Number to be submitted at the firm mnemonic level at the point of order entry.<sup>12</sup>

Furthermore, the Exchange proposes to adopt paragraph (d) to Section 14 to provide, as is the case today, that a clearing arrangement subject to a Letter of Guarantee would immediately permit the Give Up of a Restricted OCC Number by the Participant that is party to the

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<sup>12</sup> Similar to Phlx, the System will block the entry of the order from the outset. See Phlx Rule 1037(c)(ii). This is because a valid mnemonic will be required for any order to be submitted directly to the System, and a mnemonic will only be set up for a member organization if there is already a clearing arrangement in place for that firm either through a Letter of Guarantee (as is the case today) or in the case of a Restricted OCC Number, the member organization becoming an Authorized Member Organization. The System will also restrict any post-trade allocation changes if the member organization is not authorized to use a Restricted OCC Number.

arrangement. Since there is an OCC clearing arrangement already established in this case, no further action is needed on the part of the Clearing Participant or the Participant.

The Exchange also proposes to adopt paragraph (e) to Section 14 to provide that an intentional misuse of this rule is impermissible, and may be treated as a violation of Nasdaq Rule 2010A, titled “Standards of Commercial Honor and Principles of Trade,” or Chapter III, Section 1, titled “Adherence to Law.” This language will make clear that the Exchange will regulate an intentional misuse of this rule (e.g., sending orders to a Clearing Participant’s OCC account without the Clearing Participant’s consent), and that such behavior would be a violation of Exchange rules.

In light of the foregoing proposal, the Exchange also proposes to amend Chapter VI, Section 15(a), which addresses the Clearing Participant’s financial responsibility for the NOM transactions of Participants who give up the name of such Clearing Participant pursuant to, for example, a letter of guarantee. In particular, the Exchange proposes to add that every Clearing Participant shall be responsible for the clearance of NOM transactions of each Participant who gives up such Clearing Participant’s name pursuant to a written authorization to become an Authorized Participant under Chapter VI, Section 14. Lastly, the Exchange proposes two technical changes in the same provision: (1) to capitalize Letter of Guarantee for consistency throughout its Rulebook, and (2) to delete obsolete references to the letter of authorization.<sup>13</sup>

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<sup>13</sup> The Exchange has since updated its forms to combine the letter of authorization and guarantee into one Letter of Guarantee applicable to all Participants.

## Implementation

The Exchange proposes to implement the proposed rule change no later than by the end of Q3 2019. The Exchange will announce the implementation date to its Participants in an Options Trader Alert.

### 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>14</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>15</sup> in particular, in that it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in 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.

Particularly, as discussed above, several clearing firms affiliated with SIFMA have recently expressed concerns relating to the current give up process, which permits Participants to identify any Clearing Participant as a designated give up for purposes of clearing particular transactions, and have identified the current give up process (i.e., a process that lacks authorization) as a significant source of risk for clearing firms.

The Exchange believes that the proposed changes to Chapter VI, Section 14 help alleviate this risk by enabling Clearing Participants to ‘Opt In’ to restrict one or more of its OCC clearing numbers (i.e., Restricted OCC Numbers), and to specify which Authorized Participants may Give Up those Restricted OCC Numbers. As described above, all other Participants would be required to receive written authorization from the Clearing Participant before they can Give Up

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<sup>14</sup> 15 U.S.C. 78f(b).

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



that Clearing Participant's Restricted OCC Number. The Exchange believes that this authorization provides proper safeguards and protections for Clearing Participants as it provides controls for Clearing Participants to restrict access to their OCC clearing numbers, allowing access only to those Authorized Participants upon their request. The Exchange also believes that its proposed Clearing Member Restriction Form allows the Exchange to receive in a uniform fashion, written and transparent authorization from Clearing Participants, which ensures seamless administration of the rule.

The Exchange believes that the proposed Opt In process strikes the right balance between the various views and interests across the industry. For example, although the proposed rule would require Participants (other than Authorized Participants) to seek authorization from Clearing Participants in order to have the ability to give them up, each Participant will still have the ability to Give Up a Restricted OCC Number that is subject to a Letter of Guarantee without obtaining any further authorization if that Participant is party to that arrangement. The Exchange also notes that to the extent the executing Participant has a clearing arrangement with a Clearing Participant (i.e., through a Letter of Guarantee), a trade can be assigned to the executing Participant's guarantor. Accordingly, the Exchange believes that the proposed rule change is reasonable and continues to provide certainty that a Clearing Participant would be responsible for a trade, which protects investors and the public interest. Finally, the Exchange believes that adopting paragraph (e) of Section 14 will make clear that an intentional misuse of this rule (e.g., sending orders to a Clearing Participant's OCC account without the Clearing Participant's consent) will be a violation of the Exchange's rules, and that such behavior would subject a Participant to disciplinary action.

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 not necessary or appropriate in furtherance of the purposes of the Act. The Exchange does not believe that the proposed rule change will impose an unnecessary burden on intramarket competition because it would apply equally to all similarly situated Participants. The Exchange also notes that, should the proposed changes make NOM more attractive for trading, market participants trading on other exchanges can always elect to become Participants on NOM to take advantage of the trading opportunities.

Furthermore, the proposed rule change does not address any competitive issues and ultimately, the target of the Exchange's proposal is to reduce risk for Clearing Participants under the current give up model. Clearing firms make financial decisions based on risk and reward, and while it is generally in their beneficial interest to clear transactions for market participants in order to generate profit, it is the Exchange's understanding from SIFMA and clearing firms that the current process can create significant risk when the clearing firm can be given up on any market participant's transaction, even where there is no prior customer relationship or authorization for that designated transaction.

In the absence of a mechanism that governs a market participant's use of a Clearing Participant's services, the Exchange's proposal may indirectly facilitate the ability of a Clearing Participant to manage their existing customer relationships while continuing to allow market participant choice in broker execution services. While Clearing Participants may compete with executing brokers for order flow, the Exchange does not believe this proposal imposes an undue burden on competition. Rather, the Exchange believes that the proposed rule change balances

the need for Clearing Participants to manage risks and allows them to address outlier behavior from executing brokers while still allowing freedom of choice to select an executing broker.

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

No written comments were either solicited or received.

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>16</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>17</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 necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

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<sup>16</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>17</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file 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.

#### 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-NASDAQ-2019-053 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-NASDAQ-2019-053. 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-NASDAQ-2019-053 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>18</sup>

Jill M. Peterson  
Assistant Secretary

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<sup>18</sup> 17 CFR 200.30-3(a)(12).