

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-86063; File No. SR-GEMX-2019-06)

June 7, 2019

Self-Regulatory Organizations; Nasdaq GEMX, LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Amend its Rules Governing the Give Up of a Clearing Member by a Member on Exchange Transactions

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on May 24, 2019, Nasdaq GEMX, LLC (“GEMX” 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 give up of a Clearing Member³ by a Member on Exchange transactions.

The text of the proposed rule change is available on the Exchange’s Website at <http://nasdaqgemx.cchwallstreet.com/>, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The term "Clearing Member" means a Member that is self-clearing or an Electronic Access Member that clears Exchange Transactions for other Members of the Exchange. See Rule 100(a)(11).

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 Rule 707 related to the give up of a Clearing Member by a Member on Exchange transactions. This proposed rule change is substantially similar⁴ to a recently-approved rule change by the Exchange’s affiliate, Nasdaq PHLX LLC (“Phlx”),⁵ and serves to align the rules of Phlx and the Exchange.⁶

By way of background, to enter transactions on the Exchange, a Member must either be a Clearing Member or must have a Clearing Member agree to accept financial responsibility for all of its transactions. In particular, Rule 707 currently provides that a Member must give up the name of the Clearing Member through whom the transaction will be cleared. Rule 712(b)

⁴ Specifically, GEMX is not adopting sections (c)(i) and (c)(ii) of Phlx Rule 1037, which relate to how the Phlx trading system will enforce unauthorized Give Ups for floor trades and electronic trades, respectively. With respect to electronic trades, Phlx will block the order from the outset whereas GEMX will automatically default to the Member’s guarantor. See proposed GEMX Rule 707(c).

⁵ See Securities Exchange Act Release No. 85136 (February 14, 2019) (SR-Phlx-2018-72) (Approval Order).

⁶ The other Nasdaq, Inc.-owned options markets, Nasdaq BX, Nasdaq ISE, Nasdaq MRX, and The Nasdaq Options Market (collectively, “Nasdaq HoldCo Exchanges”), will file similar rule change proposals based on the Phlx filing.

provides, in relevant part, that every Clearing Member shall be responsible for the clearance of Exchange transactions of such Clearing Member and of each Member who gives up such Clearing Member's name pursuant to a letter of authorization, letter of guarantee or other authorization given by such Clearing Member to such Member, which authorization must be submitted to the Exchange. Additionally Rule 808(a) provides that no Market Maker (i.e., Primary Market Makers and Competitive Market Makers) shall make any transactions on the Exchange unless a Letter of Guarantee has been issued for such Member by a Clearing Member and filed with the Exchange.⁷

Recently, certain Clearing Members, 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 Members 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.⁸

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 Member to opt in, at The Options Clearing Corporation ("OCC") clearing number level, to a feature that, if enabled by the Clearing Member, will allow the Clearing Member to specify which Members are authorized to give up

⁷ Furthermore, the Exchange previously issued guidance on designating Give Ups in Regulatory Information Circular 2013-02. This rule change supersedes the Exchange's previous interpretation.

⁸ See note 5 above.

that OCC clearing number. Accordingly, Rule 707 will be retitled as “Authorization to Give Up,” and the current rule text will be replaced by new language. Specifically, proposed Rule 707 will provide that for each transaction in which a Member participates, the Member may indicate, at the time of the trade or through post trade allocation, any OCC number of a Clearing Member through which a transaction will be cleared (“Give Up”), provided the Clearing Member 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”). A Member may Give Up a Restricted OCC Number provided the Member has written authorization as described in paragraph (b)(ii) (“Authorized Member”).

Proposed Rule 707(b) provides that Clearing Members may request the Exchange restrict one or more of their OCC clearing numbers (“Opt In”) as described in subparagraph (b)(i) of Rule 707. If a Clearing Member Opt In, the Exchange will require written authorization from the Clearing Member permitting a Member to Give Up a Clearing Member’s Restricted OCC Number. An Opt In would remain in effect until the Clearing Member terminates the Opt In as described in subparagraph (iii). If a Clearing Member does not Opt In, that Clearing Member’s OCC number may be subject to Give Up by any Member.

Proposed Rule 707(b)(i) will set forth the process by which a Clearing Member may Opt In. Specifically, a Clearing Member may Opt In by sending a completed “Clearing Member Restriction Form” listing all Restricted OCC Numbers and Authorized Members.⁹ A copy of the

⁹ 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 Member’s contact information to assist Members (to the extent they are not already Authorized Members) 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.

proposed form is attached in Exhibit 3[sic]. A Clearing Member may elect to restrict one or more OCC clearing numbers that are registered in its name at OCC. The Clearing Member 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 Member as Authorized Members to obtain the required written authorization from the Clearing Member 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 Rule 707(b)(ii) will set forth the process for Members to Give Up a Clearing Member's Restricted OCC Number. Specifically, a Member desiring to Give Up a Restricted OCC Number must become an Authorized Member.¹⁰ The Clearing Member will be required to authorize a Member as described in subparagraph (i) or (iii) of Rule 707(b) (i.e., through a Clearing Member Restriction Form), unless the Restricted OCC Number is already subject to a Letter of Guarantee that the Member is a party to, as set forth in Rule 707(d).

Pursuant to proposed Rule 707(b)(iii), a Clearing Member may amend the list of its Authorized Members 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 Rule 707(b)(i), the Exchange may permit the Clearing Member to authorize, or remove

¹⁰ The Exchange will develop procedures for notifying Members that they are authorized or unauthorized by Clearing Members.

authorization for, a Member 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 Members if they are no longer authorized to Give Up a Clearing Member's Restricted OCC Number. If a Clearing Member removes a Restricted OCC Number, any Member may Give Up that OCC clearing number once the removal has become effective on or before the next business day.

Proposed Rule 707(c) will provide that the System will not allow an unauthorized Member to Give Up a Restricted OCC Number. Specifically, if an unauthorized Give Up with a Restricted OCC Number is submitted to the System, the System will process that transaction using the Member's default OCC clearing number.

Furthermore, the Exchange proposes to adopt paragraph (d) to Rule 707 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 Member that is party to the arrangement. Since there is an OCC clearing arrangement already established in this case, no further action is needed on the part of the Clearing Member or the Member.

The Exchange also proposes to adopt paragraph (e) to Rule 707 to provide that an intentional misuse of this Rule is impermissible, and may be treated as a violation of Rule 400, titled "Just and Equitable Principles of Trade," or Rule 401, 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 Member's OCC account without the Clearing Member'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 Rule 712(b), which addresses the Clearing Member's financial responsibility for the Exchange transactions of

Members who give up the name of such Clearing Member pursuant to, for example, a letter of guarantee. In particular, the Exchange proposes to add that every Clearing Member shall be responsible for the clearance of the Exchange transactions of each Member who gives up such Clearing Member's name pursuant to a written authorization to become an Authorized Member under Rule 707. Lastly, the Exchange proposes the following technical changes in the same provision: (1) to capitalize Letter of Guarantee for consistency throughout its Rulebook, (2) to delete obsolete references to the letter of clearing authorization,¹¹ and (3) to replace the phrase "letter of clearing authorization or letter of guarantee" with "authorization" to track the foregoing changes.

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 Members in an Options Trader Alert.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,¹² in general, and furthers the objectives of Section 6(b)(5) of the Act,¹³ 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

¹¹ GEMX recently updated its forms to combine the Electronic Access Member letter of clearing authorization and Market Maker guarantee into one Letter of Guarantee applicable to all Members.

¹² 15 U.S.C. 78f(b).

¹³ 15 U.S.C. 78f(b)(5).

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 Members to identify any Clearing Member 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 Rule 707 help alleviate this risk by enabling Clearing Members to ‘Opt In’ to restrict one or more of its OCC clearing numbers (i.e., Restricted OCC Numbers), and to specify which Authorized Members may Give Up those Restricted OCC Numbers. As described above, all other Members would be required to receive written authorization from the Clearing Member before they can Give Up that Clearing Member’s Restricted OCC Number. The Exchange believes that this authorization provides proper safeguards and protections for Clearing Members as it provides controls for Clearing Members to restrict access to their OCC clearing numbers, allowing access only to those Authorized Members 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 Members, 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 Members (other than Authorized Members) to seek authorization from Clearing Members in order to have the ability to give them up, each Member 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 Member is party to that arrangement. The Exchange also notes that to the extent the executing Member has a clearing arrangement with a Clearing Member (i.e., through a Letter of Guarantee), a trade can be assigned to the executing Member's guarantor. Accordingly, the Exchange believes that the proposed rule change is reasonable and continues to provide certainty that a Clearing Member would be responsible for a trade, which protects investors and the public interest. Finally, the Exchange believes that adopting paragraph (e) of Rule 707 will make clear that an intentional misuse of this Rule (e.g., sending orders to a Clearing Member's OCC account without the Clearing Member's consent) will be a violation of the Exchange's rules, and that such behavior would subject a Member 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 Members. The Exchange also notes that, should the proposed changes make GEMX more attractive for trading, market participants trading on other exchanges can always elect to become Members on GEMX 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 Members 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 Member's services, the Exchange's proposal may indirectly facilitate the ability of a Clearing Member to manage their existing customer relationships while continuing to allow market participant choice in broker execution services. While Clearing Members 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 Members 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 Act¹⁴ and subparagraph (f)(6) of Rule 19b-4 thereunder.¹⁵

¹⁴ 15 U.S.C. 78s(b)(3)(A)(iii).

¹⁵ 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

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.

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. Please include File Number SR-GEMX-2019-06 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-GEMX-2019-06. 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

requirement.

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-GEMX-2019-06 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.¹⁶

Eduardo A. Aleman
Deputy Secretary

¹⁶ 17 CFR 200.30-3(a)(12).