

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-79976; File No. SR-NYSEArca-2017-02)

February 6, 2017

Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend Certain Rules Related to Flexible Exchange Options

Pursuant to Section 19(b)(1)<sup>1</sup> of the Securities Exchange Act of 1934 (“Act”)<sup>2</sup> and Rule 19b-4 thereunder,<sup>3</sup> notice is hereby given that on January 25, 2017, NYSE Arca, Inc. (“NYSE Arca” or the “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II 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 certain rules related to Flexible Exchange (“FLEX”) Options. The proposed rule change is available on the Exchange’s website at [www.nyse.com](http://www.nyse.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 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 those 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 parts of such statements.

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

<sup>2</sup> 15 U.S.C. 78a.

<sup>3</sup> 17 CFR 240.19b-4.

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

1. Purpose

The purpose of this filing is to amend certain rules related to FLEX Options, as described below.

FLEX Options are customized equity or index contracts that allow investors to tailor contract terms for exchange-listed equity and index options.<sup>4</sup> The Exchange is proposing to allow FLEX Options in ByRDs, make available additional settlement styles, modify how exercise prices and premiums are expressed, change certain provisions relating to floor-based trading, and modify other related provisions pertaining to FLEX Options.

FLEX Options for Binary Return Derivatives contracts (“ByRDs”)

The Exchange proposes to modify its rules to enable market participants to trade FLEX options contracts in ByRDs.<sup>5</sup> Specifically, the Exchange proposes to add a new definition of “FLEX ByRDs,” which would be a “Binary Return Derivatives contract on any ByRD-eligible underlying security that is subject to the rules in this Section.”<sup>6</sup> The Exchange also proposes to revise Rule 5.30(b)(15) to include FLEX ByRDs in the definition of “Series of FLEX Options.”<sup>7</sup>

Because FLEX ByRDs would have to be settled in cash, based on the Volume-Weighted

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<sup>4</sup> See Rule 5.30(b)(4) (defining “FLEX option”). See generally Section 4, Flexible Exchange Options, Rules 5.30-5.44.

<sup>5</sup> ByRDs are European-style option contracts on individual stocks, exchange-traded funds (“ETFs”) and Index-Linked Securities that have a fixed return in cash based on a set strike price; satisfy specified listing criteria; and may only be exercised at expiration pursuant to the Rules of the Options Clearing Corporation (the “OCC”). See Rules 5.82(b), 5.90. For a description of “Exchange-Traded Fund Shares” and “Index-Linked Securities,” see also Rule 5.3(g) and (j).

<sup>6</sup> See proposed Rule 5.30(b)(19).

<sup>7</sup> See proposed Rule 5.30(b)(15) (proposing to add that a “Series of FLEX Options” would include, in the case of FLEX ByRDs, all such option contracts of the same class having the same expiration date, strike price, and exercise settlement amount).

Average Price (or VWAP) of the underlying security, market participants could not modify these terms.<sup>8</sup> However, market participants may trade FLEX ByRDs with non-standard strike prices and/or non-standard expiration dates. Regarding position limits, the Exchange proposes to add paragraph (b)(ii) to Rule 5.35 to provide that positions in FLEX ByRDs shall be the same as Non-FLEX ByRDs, as set forth in Rule 5.86(a), except that positions in FLEX ByRDs shall be aggregated with positions in Non-FLEX ByRDs on the same or similar underlying for the purpose of calculating position limits.<sup>9</sup> The Exchange also proposes to include in proposed Rule 5.35(b)(ii) that “[f]or purposes of the position limits established under this Rule, long positions in ‘Finish Low’ and short positions in ‘Finish High’ Binary Return Derivatives shall be considered to be on the same side of the market; and short positions in ‘Finish Low’ and long positions in ‘Finish High’ Binary Return Derivatives shall be considered to be on the same side of the market.”<sup>10</sup> Consistent with these changes, the Exchange also proposes to define Non-FLEX ByRDs as “a Non-FLEX Option that is a Binary Return Derivatives contract,” in new paragraph (b)(22) to Rule 5.30. The Exchange believes that FLEX ByRDs would enable market participants to negotiate terms that differ from standardized ByRDs, which would, in turn,

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<sup>8</sup> See “Statutory Basis” section herein (in the second paragraph) for further discussion.

<sup>9</sup> The Exchange also proposes to re-format Rule 5.35 to make clear the position limits that apply to each of FLEX Index Options and FLEX Equity Options. In this regard, the Exchange proposes to modify the title of the Rule 5.35 to remove reference to “Index” and re-titled it as “Position Limits for FLEX Options.” Further, the Exchange proposes reformatting changes to clarify that Rule 5.35(a), with proposed sub-parts (i) and (ii), refers to FLEX Index Options and proposed Rule 5.35(b), refers to FLEX Equity Options. Finally, the Exchange proposes to re-locate current paragraph (d) to Rule 5.35 regarding the aggregation of position limits for FLEX Index Options to proposed paragraph (a)(iii), which would add clarity and consistency to Exchange rules. See proposed Rule 5.35(a) and (b).

<sup>10</sup> See “Statutory Basis” section herein (in the third paragraph) for further discussion.

provide greater opportunities for investors to manage risk through the use of FLEX Options.<sup>11</sup>

The Exchange notes that the proposed rules related to FLEX ByRDs are materially identical to rules recently approved on another options exchange.<sup>12</sup>

#### Additional Settlement Styles for FLEX Options: Asian and Cliquet Style

The Exchange proposes to permit parties to FLEX Index Options on Broad-Based Index Options to designate Asian style settlement and Cliquet style settlement, both of which are currently offered on another options exchange.<sup>13</sup>

As proposed in new paragraph (e)(5) of Rule 5.32 and new paragraph (b)(20) of Rule 5.30, FLEX Index Options on Broad-Based Index Options with Asian style settlement would be cash-settled call<sup>14</sup> option contracts for which the final payout would be based on an arithmetic average of specified closing prices of an underlying Broad-Based Index taken on twelve predetermined monthly observation dates, including the expiration date (“Asian option”). The monthly observation dates would be determined by working backwards from the farthest out observation date prior to the expiration date. When the scheduled observation date for an Asian option occurs on a holiday or a weekend, the observation would occur on the immediately

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<sup>11</sup> The Exchange also proposes to modify Rule 5.32(f)(3)(ii) to provide that FLEX ByRDs must be settled the same as non-FLEX ByRDs. See proposed Rule 5.32(f)(3)(ii) (discussed herein under “Additional Updates to Reflect Trading in FLEX Options”); see also Rule 5.89 (Determination of the Settlement Price of ByRDs).

<sup>12</sup> See Securities Exchange Act Release Nos. 79125 (October 19, 2016), 81 FR 73452 (October 25, 2016) (“MKT Approval Order”) (order approving modifications to FLEX Options, including adding FLEX ByRDs); 78348 (July 15, 2016), 81 FR 47469 (July 21, 2016) (“MKT Notice”) (SR-NYSEMKT-2016-48). See also NYSE MKT Rules 900G(b)(16),(17), (22); 903G(c)(3)(i)-(ii); 906G(b)(ii).

<sup>13</sup> See e.g., Chicago Board Options Exchange, Inc. (“CBOE”) Rules 24A.1 (Definitions), 24A.4 (Terms of FLEX Options), 24B.1 (Definitions) and 24B.4 (Terms of FLEX Options). See also NYSE MKT Rules 900G(b)(18), (19); 903G(b)(4),(5). FLEX ByRDs could not be settled using Asian or Cliquet settlement. See, e.g., supra note 11.

<sup>14</sup> Puts would not be permitted.

preceding business day. The exercise settlement amount for Asian options would be calculated similarly to other options (i.e., the difference between the strike price and the averaged settlement value would determine the value, or “moneyness” of the contract at expiration). Asian options would have a term of approximately one year and would expire anytime from 350 to 371 days (i.e., approximately 50 to 53 calendar weeks) from the date of initial listing. The contract multiplier (or Index Multiplier) for an Asian option that settles in U.S. dollars would be \$100, for example.<sup>15</sup> Finally, because settlement value is determined by observations taken over a 12-month period, Asian style settlement requires European-style exercise. An example of an Asian FLEX call option expiring in-the-money follows. On January 21, 2015, an investor hedging the value of XYZ Index over a year purchases a call option expiring on January 22, 2016 with a strike price of 2000 and a contract multiplier of \$100. The option has monthly observation dates occurring on the 23rd of each month.

<b>Monthly Observation Date</b>	<b>XYZ Index Closing Value</b>
23-Feb-15	2025.36
23-Mar-15	2049.34
23-Apr-15	2019.77
<b>22-May-15*</b>	1989.65
23-Jun-15	2005.64
23-Jul-15	2035.10
<b>21-Aug-15*</b>	2032.15
23-Sep-15	2076.18
23-Oct-15	2099.01
23-Nov-15	2109.32
23-Dec-15	2085.42
22-Jan-16	2084.81

<sup>15</sup> See Rule 5.30(b)(9) providing that Index Multiplier means the monetary amount, stated in terms of the settlement currency specified in the contract, by which the current index value is to be multiplied to arrive at the value required to be delivered to the holder of a call or by the holder of a put upon valid exercise of the option and setting forth the established Index Multipliers for FLEX Index Options on domestic indices.

<b>Exercise (Averaged) Settlement Value</b>	$24,611.75/12 = \mathbf{2050.98}$
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\* Because Asian FLEX options use the “preceding business day convention,” the dates of May 23, 2015 and August 23, 2015, were not used in the above example because those dates will fall on a weekend or a holiday. Instead the business days immediately preceding those dates were used as the monthly observation date.

If, in the above example, the strike price for the Asian FLEX call option was 2060, that contract would have expired out-of-the-money. This is because the exercise settlement value for this 2060 call option is equal to 2050.98 (when rounded). Since the strike price of 2060 is more than the 2050.98 exercise settlement value, this option would not be exercised and would expire worthless.

As proposed in new paragraph (e)(6) of Rule 5.32 and new paragraph (b)(21) of Rule 5.30, FLEX Index Options on Broad-Based Index Options with Cliquet style settlement would be cash-settled call<sup>16</sup> option contracts for which the final payout would be based on the sum of monthly returns (i.e., percent changes in the closing value of the underlying Broad-Based Index from one month to the next), subject to a monthly return “cap” (e.g., 3%) , applied over twelve monthly observation dates (“Cliquet option”). Cliquet options would have a term of approximately one year and would expire anytime from 350 to 371 days (which is approximately 50 to 53 calendar weeks) from the date of initial listing. The contract multiplier for a Cliquet option that settles in U.S. dollars, for example, would be \$100.<sup>17</sup>

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<sup>16</sup> Puts would not be permitted.

<sup>17</sup> See id.

The parties to a Cliquet option would designate a set of monthly observation dates for each contract and an expiration date for each contract. The monthly observation date would be the date each month on which the price of the underlying broad-based index would be observed for the purpose of calculating the exercise settlement value for Cliquet FLEX Options. Each Cliquet FLEX Option would have 12 consecutive monthly observation dates (which includes an observation on the expiration date) and each observation would be based on the closing price of the underlying broad-based index. The specific monthly observation dates would be determined by working backwards from the farthest out observation date prior to the expiration date. When the scheduled observation date for a Cliquet option occurs on a holiday or a weekend, the observation would occur on the immediately preceding business day. The parties may not designate a subsequent business day convention for Cliquet options.

The parties to a Cliquet option would designate a capped monthly return (percent change in the closing values of the underlying broad-based index from one month to the next month) for the contract, which would be the maximum monthly return that would be included in the calculation of the exercise settlement value for the contract. On each monthly observation date, the Exchange would determine the actual monthly return (the percent change of the underlying broad-based index) using the closing value of the broad-based index on the current monthly observation date and the closing value of the broad-based index on the previous monthly observation date. The Exchange would then compare the actual monthly return to the capped monthly return. The value to be included as the monthly return for a Cliquet option would be the lesser of the actual monthly return or the capped monthly return.

For example, if the actual monthly return of the underlying broad-based index was 1.75% and the designated capped monthly return for a Cliquet option was 2%, the 1.75% value would

be included (and not the 2%) as the value for the observation date to determine the exercise settlement value. Using this same example, if the actual monthly return of the underlying broad-based index was 3.30%, the 2% value would be included (and not the 3.30%) as the value of the observation date to determine the exercise settlement value. This latter example illustrates that Cliquet options have a capped upside. Cliquet options do not, however, have a capped downside for the monthly return that would be included in determining the exercise settlement value. Drawing on this same example, if the actual monthly return of the underlying broad-based index was -4.07%, the -4.07% value would be included as the value for the observation date to determine the exercise settlement value. There would be, however, be a global floor for Cliquet options so that if the sum of the monthly returns is negative, a Cliquet option would expire worthless.

Unlike other options, Cliquet options would not have a traditional exercise (strike) price. Rather, the exercise (strike) price field for a Cliquet option would represent the designated capped monthly return for the contract and would be expressed in dollars and cents. For example, a capped monthly return of 2.25% would be represented by the dollar amount of \$2.25. The “strike” price for a Cliquet option may only be expressed in a dollar and cents amount and the “strike” price for a Cliquet option may only span a range between \$0.05 and \$25.95. In addition, the “strike” price for a Cliquet option may only be designated in \$0.05 increments, e.g., \$1.75, \$2.50, \$4.15. Increments of \$0.01 in the “strike” price field (representing the capped monthly return) would not be permitted.

The first “monthly” return for a Cliquet option would be based on the initial reference value, which would be the closing value of the underlying broad-based index on the date a new Cliquet option is listed. The time period measured for the first “monthly” return would be



between the initial listing date and the first monthly observation date. For example, if a Cliquet option was opened on January 1 and the parties designated the 31st of each month as the monthly observation date, the measurement period for the first monthly return would span the time period from January 1 to January 31. The time period measured for the second monthly return, and all subsequent monthly returns, would run from the 31st of one month to the 31st of the next month (or the last Exchange business day of each month depending on the actual number of calendar days in each month covered by the contract).

Cliquet options would have European-style exercise and may not be exercised prior to the expiration date. The exercise settlement value for Cliquet options would be equal to the initial reference price of the underlying broad-based index multiplied by the sum of the monthly returns (with the cap applied) on the 12 consecutive monthly observation dates, which include the expiration date of the option, provided that the sum is greater than 0. If the sum of the monthly returns (with the applied cap) is 0 or a less, the option would expire worthless.

An example of a Cliquet option follows. On January 21, 2015, an investor hedging the value of the S&P 500 Index over a year purchases a Cliquet FLEX call option expiring on January 22, 2016 with a capped monthly return of 2% and a contract multiplier of \$100. The initial reference price of the S&P 500 Index (closing value) on January 21, 2015 is 2000. The option has monthly observation dates occurring on the 23rd of each month.

<b>Monthly Observation Date</b>	<b>S&amp;P 500 Index Closing Value (Si)</b>	<b>Actual Monthly Return</b>	<b>Capped Monthly Return (CMR<sub>i</sub>)</b>	<b>Sum of Monthly Returns</b>
23-Feb-15	2025.36	1.27%	1.27%	1.27%
23-Mar-15	2049.34	1.18%	1.18%	2.45%
23-Apr-15	2019.77	-1.44%	-1.44%	1.01%

<b>22-May-15*</b>	1989.65	-1.49%	-1.49%	-0.48%
23-Jun-15	2005.64	0.80%	0.80%	0.32%
23-Jul-15	2035.10	1.47%	1.47%	1.79%
<b>21-Aug-15*</b>	2032.15	-0.14%	-0.14%	1.65%
23-Sep-15	2076.18	2.17%	<b>2.00%**</b>	3.65%
23-Oct-15	2099.01	1.10%	1.10%	4.75%
23-Nov-15	2109.32	0.49%	0.49%	5.24%
23-Dec-15	2085.42	-1.13%	-1.13%	4.11%
22-Jan-16	2084.81	-0.03%	-0.03%	<b>4.08%</b>
<b>Exercise Settlement Value</b>	[(4.08% * 2000.00)] + 2 = 83.60			

\* Because Cliquet FLEX options use the “preceding business day convention,” the dates of May 23, 2015, and August 23, 2015, were not used in the above example because those dates fall on a weekend or a holiday. Instead the business days immediately preceding those dates were used as the monthly observation dates.

\* \*Monthly capped return applied.

The exercise settlement amount for this January 22, 2016 Cliquet option, with a capped monthly 2% return (“strike price”) and a contract multiplier of \$100 would be equal to \$8,360. This value would be calculated by summing the monthly capped returns (equal to 4.08%) and multiplying that amount by the initial reference price (equal to 2000), which equals 81.60. The “strike price” (2%) amount would then be added to that amount (81.60) to arrive at an exercise settlement value of 83.60. Because the “strike price” field for a Cliquet option would be the manner in which the designated capped monthly return would be identified for the contract and because the designated monthly return for the contract would have been already substantively applied to determine the exercise settlement value, the “strike price” of 2.0 would be subtracted

from the exercise settlement value before the contract multiplier (\$100) would be applied [(83.60 - 2) \* 100]. Accordingly, resulting payout for this contract would be \$8,160.

If the sum of the monthly capped returns had been negative, this option would have expired worthless.

Regarding the proposed settlement styles, the Exchange would use the same surveillance procedures currently utilized for the Exchange's other FLEX Options, including FLEX Index Options.<sup>18</sup> The Exchange further represents that these surveillance procedures will be adequate to monitor trading in these option products. For surveillance purposes, the Exchange would have access to information regarding trading activity in the pertinent underlying securities.

#### FLEX Exercise Prices and Premiums

The Exchange also proposes to modify how exercise prices and premiums for FLEX Options may be expressed, which would reflect recent changes in the marketplace. The Exchange notes that when it adopted rules for FLEX Options, strike prices were designated in one-eighth of a dollar, and options were priced in fractions of a dollar.<sup>19</sup> Now that decimalization has been applied to options trading, including trading in FLEX Options, certain exchange rules have been revised to reflect the decimal equivalent of a previously approved fractional term. Thus, the Exchange proposes to collapse current Rules 5.32(f)(2) and (f)(5) into a revised Rule 5.32(f)(2), to provide that exercise prices and premiums may be stated in terms of:

- (i) a dollar amount; (ii) a method for fixing such a number at the time a FLEX Request for Quote or FLEX Order is traded; or (iii) a percentage of

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<sup>18</sup> See "Statutory Basis" section herein (in the fourth paragraph) for further discussion.

<sup>19</sup> See Rule 5.32(f)(2) (providing that exercise prices may be rounded to the nearest .10 or one-eighth of a dollar) and (f)(5) (providing that exercise prices may be rounded to the nearest .10).

the price of the underlying security at the time of the trade or as of the close of trading on the Exchange on the trade date.

The Exchange notes that this change would align with the Exchange's treatment of FLEX Index Options as well as the rules of other exchanges.<sup>20</sup> In addition, the Exchange proposes to modify Rule 5.32 by adding new paragraph (e)(2)(C) and modifying paragraph (f)(2) to provide that:

Exercise prices may be rounded to the nearest minimum tick or other decimal increment determined by the Exchange on a class-by-class basis that may not be smaller than \$0.01. Premiums will be rounded to the nearest minimum tick. For exercise prices and premiums stated using a percentage-based methodology, such values may be stated in a percentage increment determined by the Exchange on a class-by-class basis that may not be smaller than 0.01% and will be rounded as provided above.<sup>21</sup>

The Exchange notes that this proposed change is consistent with the rules of another options exchange.<sup>22</sup> The Exchange believes this change would provide greater flexibility in terms of describing an option contract tailored to the needs of the investor.

#### Additional Updates to Reflect Trading in FLEX Options

The Exchange is also proposing the following modifications to streamline and update FLEX Options Rules:

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<sup>20</sup> See, e.g., Rule 5.32(e)(2); CBOE Rule 24A.4(b)(2) and (c)(2); NYSE MKT Rules 903G(b)(1), (c)(2).

<sup>21</sup> See proposed Rule 5.32(e)(2)(C) and (f)(2). The proposed rule removes reference to exercise prices being rounded to the nearest tenth or one-eighth of a dollar. See id.

<sup>22</sup> See, e.g., CBOE Rule 24A.4(b)(2) (permitting bids and offers, strikes and premiums to be expressed in increments determined by the Exchange, which increments may be no smaller than \$0.01). See also NYSE MKT Rules 903G(b)(1), (c)(2).

- “FLEX” Options. The Exchange proposes to define “FLEX” as shorthand for Flexible Options in the title of Section 4.<sup>23</sup>
- Flex Post Official. The Exchange proposes to modify the name of “FLEX Post Official” to eliminate “Post” from the title to more accurately reflect the position.<sup>24</sup> When the Exchange first began trading FLEX Options, it designated FLEX Post Officials to refer to specially qualified Trading Officials stationed at specific FLEX posts to address the nuances related to those products (e.g., the method for announcing a Request for Quotes and appointing FLEX Qualified Market Makers). However, as trading in FLEX Options gained popularity, it became apparent that liquidity for FLEX Options was more readily available at trading posts where the standard options in the underlying security traded rather than at a specific FLEX post. Thus, the Exchange proposes to change the name of “FLEX Post Official” in Rules 5.30(b)(7) and 5.38 to eliminate the reference to physical FLEX posts and to refer simply to “FLEX Officials”, which would better reflect the realities of trading FLEX Options on the Exchange and clarify and add transparency to Exchange rules.<sup>25</sup>
- FLEX Trading Procedures and Principles. The Exchange proposes to modify Rule 5.33 (FLEX Trading Procedures and Principles) to likewise update the rule

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<sup>23</sup> See proposed Section 4 (Flexible Exchange (“FLEX”) Options). The Exchange also proposes to revise Rule 5.30(b)(2) to remove an errant semi-colon from the term “BBO Improvement Interval.”

<sup>24</sup> See proposed Rule 5.30(b)(7) and 5.38.

<sup>25</sup> See proposed Rules 5.30(b)(7), 5.37(c), and 5.38. Similarly, because there are no longer physical posts on the Trading Floor that are solely “FLEX posts,” the Exchange proposes to remove the FLEX modifier from Rule 5.33(b)(1) and Rule 6.78(e)(1)(C) and (E) (Transactions Off the Exchange), such that the revised rule text refers only to a “post.” See proposed Rules 5.33(b)(1) and 6.78(e)(1)(C), (E).

text to accurately reflect trading in FLEX Options. First, the Exchange proposes to modify paragraphs (a)(1) and (2) of Rule 5.33, which provide that FLEX Market Makers handle Requests for Quotes from OTP Holders and OTP Firms when, [sic] to more appropriately reflect that FLEX Officials conduct this work on the Exchange. Thus, the Exchange proposes to replace references to FLEX Market Maker with FLEX Official in Rule 5.33(a)(1)-(2).<sup>26</sup> The Exchange notes that FLEX Officials are Exchange employees that report to the regulatory officer of the Exchange. As such, the Exchange would ensure that each FLEX Official, or any other designated qualified employees called in to assist the FLEX Official, are properly qualified and meet any necessary requirements.<sup>27</sup> The Exchange believes the regulatory oversight of FLEX transactions by a properly qualified FLEX Official could help to ensure that FLEX transactions comply with the FLEX rules.<sup>28</sup> The proposal to replace certain duties of a FLEX Market Maker with respect to FLEX Options transactions with duties assigned to a FLEX Official, who is an Exchange employee, is consistent with the FLEX rules of other exchanges.<sup>29</sup> Second, consistent with the foregoing changes, the Exchange proposes to modify Rule 5.33(a)(2) and (c)(1)-(3) to more accurately reflect the handling of FLEX Quotes and requests for such quotes. When the Exchange introduced FLEX Options, the Exchange displayed FLEX Request for Quotes and

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<sup>26</sup> The Exchange notes that reference to FLEX Official is consistent with proposed Rule 5.30(b)(7).

<sup>27</sup> See proposed Rule 5.38 (detailing duties of Exchange employees designated to act as FLEX Officials).

<sup>28</sup> See id.

<sup>29</sup> See, e.g., CBOE Rule 24A.5(a)(i) and (ii), 24A.12(b) ; MKT Rule 900G(21) and 910G [sic].

FLEX Quotes at the FLEX post. However, over time, Floor Participants would ask Floor Brokers to communicate the existence of trading interest in particular FLEX Options through various means to their customers and correspondents. Thus, the Exchange proposes to revise the rules to reflect that the FLEX Request for Quotes or the FLEX Quotes are “disseminated” (rather than displayed), which would add clarity and transparency to Exchange rules.<sup>30</sup>

- Obsolete Foreign Currencies. The Exchange proposes to modify rule text relating to FLEX Options to remove obsolete references to foreign currencies that are no longer in circulation, which would add clarity and transparency to Exchange rules. Specifically, the Exchange proposes to remove references in the FLEX rules to Deutsche Marks and French Francs.<sup>31</sup>
- FLEX Options Trading. The Exchange proposes to collapse the two separate current Rules 5.31(a) (Hours of Trading) and 5.31(b) (Trading Rotations) into a single proposed Rule 5.31, FLEX Option Trading, with the paragraphs (a) and (b) providing the same headings and substantive rule text, which would add internal consistency to the format of Exchange rules.<sup>32</sup>
- Terms of FLEX Options. The Exchange proposes to modify several aspects of Rule 5.32 (Terms of FLEX Options). First, the Exchange proposes to clarify that each FLEX Request for Quote and FLEX contract must contain the underlying

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<sup>30</sup> See proposed Rule 5.33(a)(2) and (c)(1)-(3).

<sup>31</sup> See proposed Rules 5.30(b)(9), 5.32(e)(4), 5.33(g).

<sup>32</sup> See proposed Rule 5.31. The Exchange proposes two non-substantive revisions to existing rule text to add the word “Options” after “FLEX” and capitalizing the “o” in Options at the end of paragraph (a). Both changes would add clarity to Exchange rules by consistently referring to the defined term “FLEX Options.” See proposed Rule 5.31(a).

security in the case of FLEX Equity Options or (rather than “and”) underlying index, in the case of FLEX Index Options.<sup>33</sup> The Exchange believes this change would add clarity and transparency to Exchange rules.

Second, the Exchange proposes to modify Rule 5.32(b)(7) to make clear that the minimum size of one contract for FLEX Options applies to both transactions (per current rule text) “and quotations” (per proposed rule text). This proposed change corresponds to the Commission’s approval, in 2014, of the Exchange’s proposal to adopt on a permanent basis its pilot program regarding minimum value sizes for opening transactions in new series of FLEX Options and FLEX Quotes.<sup>34</sup> The Exchange believes this change would add clarity and transparency to Exchange rules.

The Exchange is proposing to modify Rule 5.32(f)(3) to address exercise settlement of FLEX Options that are FLEX ByRDs, as the current rule only addresses exercise settlement by physical delivery.<sup>35</sup> Specifically, the Exchange proposes to designate the current description of exercise settlement by physical delivery as paragraph (3)(i) and to make clear this provisions applies solely to FLEX Equity Options other than FLEX ByRDs. Finally, the Exchange proposes paragraph (3)(ii) to state that exercise settlement and style of FLEX ByRDs would be

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<sup>33</sup> See proposed Rule 5.32(b)(1). The Exchange also proposes to modify the punctuation Rule 5.32(b)(6) from a period to a semi-colon and to add the word “and” to add internal consistency to Exchange rules.

<sup>34</sup> See Securities and Exchange Act Release No. 72537 (July 3, 2014) 79 FR 39442 (July 10, 2014) (SR-NYSEArca-2014-25). In addition, the Exchange proposes to eliminate text from Rule 5.36(b)-(c) (Exercise Limits) that contradicts the approved one contract minimum size for FLEX transactions.

<sup>35</sup> Rule 5.32(f)(3) currently provides that “[e]xercise settlement shall be by physical delivery of the underlying security or Exchange-Traded Fund Shares.”



the same as Non-FLEX ByRDs, pursuant to the VWAP settlement provision set forth in Rule 5.89 and pursuant to the European exercise style set forth in Rule 5.82(b)(1).”<sup>36</sup>

Finally, the Exchange also proposes to modify Commentary .01 to Rule 5.32, to provide that FLEX Options may be permitted in puts and calls that do not have identical terms, including, as proposed, “the same settlement style.” Commentary .01 to Rule 5.32 is designed to prevent the trading of a FLEX Option that has the exact same terms (underlying security, exercise style, expiration date, exercise price and, as proposed, settlement style) as a Standard or (non-FLEX) Option. In other words, as long as just one term of the FLEX Option is different from an existing “regular” or “non-FLEX” option it may be traded as a FLEX Option.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Securities Exchange Act of 1934 (the “Act”),<sup>37</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>38</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, 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.

The Exchange believes that the proposal to add FLEX ByRDs would remove impediments to and perfect the mechanism of a free and open market as FLEX ByRDs would enable market participants to negotiate terms that differ from standardized ByRDs, which would, in turn provide greater opportunities for investors to manage risk through the use of FLEX Options to the benefit of investors and the public interest. The Exchange notes that ByRDs are

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<sup>36</sup> See proposed Rule 5.32(f)(3)(i)-(ii).

<sup>37</sup> 15 U.S.C. 78f(b).

<sup>38</sup> 15 U.S.C. 78f(b)(5).

subject to heightened initial and continued listing standards and the settlement price based on an all-day VWAP, which should address any potential manipulation concerns.<sup>39</sup> The Exchange believes that specifying that FLEX ByRDs can only be traded on ByRDs-eligible underlying securities that meet the same heightened initial and continued listing standards as ByRDs, thereby helping to ensure that only highly capitalized, actively traded stocks and ETFs will underlie cash-settled FLEX ByRDs, as well as requiring settlement based on all-day VWAP (as required for standardized ByRDs), should help to mitigate concerns about manipulation in the underlying security to benefit a position in FLEX ByRDs.<sup>40</sup>

The Exchange further believes that establishing position limits for FLEX ByRDs to be the same as Non-FLEX ByRDs position limits, which are currently 25,000 contracts on the same side of the market,<sup>41</sup> and aggregating positions in Flex ByRDs with Non-FLEX ByRDs on the same or similar underlying security for purposes of calculating position limits is reasonable and consistent with the Act. In approving position limits for ByRDs, the Commission noted that these position limits appeared to reasonably balance the promotion of a free and open market for these securities with minimization of incentives for market manipulation.<sup>42</sup> By establishing the same position limits for FLEX ByRDs as for Non-FLEX ByRDs and, importantly, aggregating such

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<sup>39</sup> See Securities Exchange Act Release No. 56251 (August 14, 2007), 72 FR 46523, 46524 (August 20, 2007) (SR-Amex-2004-27) (“ByRDs Order”). See also Securities Exchange Act Release No. 77044 (February 3, 2016), 81 FR 6908 (February 3, 2016) (SR-Arca-2016-16) (immediate effectiveness filing adopting rules relating to ByRDs).

<sup>40</sup> See MKT Approval Order, *supra* note 12, 81 FR at 73457.

<sup>41</sup> The exercise limits for FLEX ByRDs will be equivalent to the position limits for FLEX ByRDs described in proposed Rule 5.35(b)(ii). See Rule 5.36.

<sup>42</sup> See ByRDs Order, *supra* note 39, 72 FR at 76525.

positions on the same side of the market,<sup>43</sup> the Exchange similarly believes that the position limit requirements for FLEX ByRDs should help to ensure that the trading of FLEX ByRDs would not increase the potential for manipulation and could help to minimize such incentives. Moreover, as noted above, because FLEX ByRDs must, like standardized ByRDs, be cash settled, European-style exercise, with a settlement price based on an all-day VWAP (and meet heightened listing and continued listing standards), unlike other FLEX Options, the only non-standardized terms that can be flexed are strike prices and expiration dates. Further, the Exchange would surveil trading in FLEX ByRDs utilizing existing surveillance procedures pertaining to Non-FLEX ByRDs and FLEX Options. Finally, the Exchange notes that its proposal to offer FLEX ByRDs is consistent with the rules of another options exchange and therefore raise no novel issues for the Commission.<sup>44</sup>

The Exchange believes that the proposal to permit additional settlement types – Asian and Cliquet – would remove impediments to and perfect the mechanism of a free and open market because the proposed rule change would provide OTP Holders with enhanced methods to manage risk by more finely tailoring a FLEX Option, within specified limits, to the underlying security or index through a variety of settlement calculations and styles. In addition, this proposal would promote just and equitable principles of trade and protect investors and the general public because the additional settlement styles for FLEX Options would provide investors with additional trading and hedging tools. The Exchange also believes that the Exchange’s proposal to allow Asian and Cliquet style settlement for FLEX Index Options on

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<sup>43</sup> For purposes of these position limits, long positions in “Finish Low” and short positions in “Finish High” ByRDs would be considered to be on the same side of the market; and short positions in “Finish Low” and long positions in “Finish High” ByRDs would be considered to be on the same side of the market. See proposed Rule 5.35 (b)(ii).

<sup>44</sup> See MKT Approval Order, supra note 12.

Broad-Based Index Options may give investors and other market participants the ability to individually tailor, within specified limits, certain terms of those options. Furthermore, the Exchange believes that, since both Asian and Cliquet settlement styles depend on multiple measurements in determining the settlement value, both settlement styles could help mitigate the potential for manipulation in the underlying security(ies). Further, the Exchange notes that its proposal to offer Asian and Cliquet-style settlement for FLEX Index Options is consistent with the rules of another options exchange and therefore raise no novel issues for the Commission.<sup>45</sup>

The Exchange believes the proposed changes to FLEX Exercise Prices and Premiums would remove impediments to and perfect the mechanism of a free and open market as this change would provide greater flexibility in terms of describing an option contract tailored to the needs of the investor. In addition, the Exchange believes that the proposal to specify how exercise prices and premium for FLEX Index Options and FLEX Equity Options will be rounded and how they will be stated using a percentage-based methodology should provide greater clarity and allow market participants to specify contracts that meet their particular needs. In addition, the proposed changes would promote internal consistency in our own rules (including by removing a reference to fraction pricing to be consistent with the shift to decimal pricing found elsewhere in Exchange rules) and would align our rules with that of another options exchange and therefore raise no novel issues for the Commission.<sup>46</sup>

Regarding the proposed settlement styles, the Exchange would use the same surveillance procedures currently utilized for the Exchange's other FLEX Options, including FLEX Index Options. The Exchange further represents that these surveillance procedures shall be adequate to

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<sup>45</sup> See supra note 13.

<sup>46</sup> See supra note 20.

monitor trading in options on these option products. For surveillance purposes, the Exchange would have complete access to information regarding trading activity in the pertinent underlying securities.

The Exchange believes the proposal to provide that FLEX Officials, and not FLEX Market Makers, would be responsible for assuring that a Request for Quotes is submitted properly as a FLEX Option and for displaying the terms and specifications of the Request for Quotes would remove impediments to and perfect the mechanism of a free and open market as the regulatory oversight of FLEX transactions by a properly qualified FLEX Official could help to ensure that FLEX transactions comply with the FLEX rules.

Finally, the remaining proposed changes to FLEX Options would remove impediments to and perfect the mechanism of a free and open market as the changes correct inaccuracies in rule text and update the rules to better reflect the Exchange's current practices with respect to FLEX Options, which have evolved over time. In particular, the Exchange believes that the proposed changes to refer to FLEX Requests for Quotes and FLEX Quotes as being disseminated and remove the concept of a post specific to the trading of FLEX options will align the rules with current trading practices on the Exchange's floor. The Exchange believes the proposed changes would provide transparency and internal consistency within Exchange rules and operate to protect investors and the investing public by making the Exchange rules easier to navigate and comprehend.

**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 that is not necessary or appropriate in furtherance of the purposes of the Act. The proposal is designed to increase competition for order flow on the Exchange in a manner that is

beneficial to investors because it is designed to provide investors seeking to effect FLEX Option orders with the opportunity for different methods of settling option contracts at expiration. The proposed changes are also designed to update Exchange rules regarding FLEX Options, including by removing obsolete references, which should likewise improve the competitiveness of the Exchange by making it a more attractive venue for trading.

The Exchange notes that it operates in a highly competitive market in which market participants can readily direct order flow to competing venues who offer similar functionality. The Exchange also believes the proposed rule change promotes competition because it would enable the Exchange to provide market participants with FLEX Options transaction possibilities that are similar to that of other options exchanges. The Exchange believes the proposed rules encourage competition amongst market participants to provide tailored FLEX Options contracts.

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

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The Exchange has filed the proposed rule change pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>47</sup> and Rule 19b-4(f)(6) thereunder.<sup>48</sup> Because the 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 prior to 30 days from the date on which it was filed, or such shorter time as the Commission may designate, if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6)(iii) thereunder.

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<sup>47</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>48</sup> 17 CFR 240.19b-4(f)(6).

At any time within 60 days of the filing of such 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 under Section 19(b)(2)(B)<sup>49</sup> of the Act to determine whether the proposed rule change 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](mailto:rule-comments@sec.gov). Please include File Number SR-NYSEArca-2017-02 on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NYSEArca-2017-02. 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

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<sup>49</sup> 15 U.S.C. 78s(b)(2)(B).

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 such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NYSEArca-2017-02, 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>50</sup>

Robert W. Errett  
Deputy Secretary

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<sup>50</sup> 17 CFR 200.30-3(a)(12).