

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-83724; File No. SR-OCC-2018-010)

July 27, 2018

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend the Definition of Flexibly Structured Options

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 July 16, 2018, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by OCC. OCC filed the proposed rule change pursuant to Section 19(b)(3)(A)³ of the Act and Rule 19b-4(f)(4)(ii)⁴ thereunder so that the proposal was effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Proposed Rule Change

OCC proposes to amend the definition of the term “flexibly structured option” as provided in Article I, Section 1.F.(8) of OCC’s By-Laws to conform the definition to a recent rule change by Cboe Exchange, Inc. (“Cboe Options” or “CBOE”). The proposed changes to OCC’s By-Laws can be found in Exhibit 5 to the filing. All terms with initial

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(4)(ii).

capitalization that are not otherwise defined herein have the same meaning as set forth in the By-Laws and Rules.⁵

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, OCC 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. OCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(1) Purpose

Flexibly structured options are options that give investors the ability to customize basic option features including size, expiration date, exercise style, and certain exercise prices. OCC currently defines a "flexibly structured option" as an option having variable terms that are negotiated between the parties to a confirmed trade pursuant to Exchange Rules and that do not correspond to the variable terms⁶ of any series of non-flexibly structured options previously opened for trading on the Exchange (other than a series of

⁵ OCC's By-Laws and Rules can be found on OCC's public website: <http://optionsclearing.com/about/publications/bylaws.jsp>.

⁶ OCC By-Laws, Article I., Section 1.V.(1), which defines "variable terms" in respect of a series of option contracts other than OTC options to mean "the name of the underlying interest, the exercise price (or, in respect of a series of delayed start options that does not yet have a set exercise price, the exercise price setting formula and exercise price setting date), the index value determinant and the index multiplier (in the case of a flexibly structured index option), the cap interval (in the case of a capped option) and the expiration date of such option contract."

quarterly options or short term options).⁷ In addition, OCC's By-Laws currently provide that once a series of non-flexibly structured options (other than a series of quarterly options or short term options) is opened for trading on an options exchange, any existing flexibly structured option contracts that have identical variable terms shall be fully fungible with options in such series, and shall cease to be flexibly structured options.⁸ In other words, with the exception of quarterly options and short term options series, once an exchange opens a non-flexibly structured option series having identical terms to a flexibly structured option, the flexibly structured option would become fungible with the non-flexibly structured option series.

Pursuant to a recent rule change, Cboe Options has made all flexibly structured options fungible with subsequently-introduced non-flexibly structured options series having identical variable terms.⁹ This includes non-flexibly structured quarterly options and short term options series.¹⁰ As a result, for instance, under Cboe Options' rules, a

⁷ OCC By-Laws, Article I. Non-flexibly structured weekly options are called "short term options" in OCC's By-Laws and Rules. Under Article I of OCC By-Laws, the term "quarterly option" means "an option of a series of stock options or index options that expires on the last business day of a calendar quarter," and the term "short term option" means "an option of a series of options that expires one week after it is opened for trading."

⁸ OCC By-Laws, Article I., Section 1.F.(8).

⁹ See Securities Exchange Act Release No. 83205 (May 9, 2018), 83 FR 22550 (May 15, 2018) (SR-CBOE-2018-008) (Order Approving a Proposed Rule Change Relating to Flexibly Structured Options) ("Cboe Options has proposed to amend the rule to make all FLEX Options fungible with Non-FLEX Options that have identical terms.")

¹⁰ This also includes weekly expirations and End of Month ("EOM") expirations. Cboe Options stated in its proposal that flexibly structured options with these expirations were not originally intended to be fungible. See Securities Exchange Release Act No. 82622 (February 2, 2018), 83 FR 5668 (February 8, 2018) (SR-CBOE-2018-008) (Notice of Filing of a Proposed Rule Change Relating to Flexibly Structured Options).

flexibly structured option that has the same terms as a subsequently-introduced quarterly or short term option series would now be fungible with that non-flexibly structured quarterly or short term option series.

Cboe Options has requested that OCC amend its By-Laws to allow Cboe Options' rule change to become effective. Cboe Options noted in its rule change that the change "will have the effect of more FLEX Options becoming fungible with Non-Flex Options, which will potentially increase the liquidity available to traders of FLEX Options."¹¹

To clear and settle flexibly structured options traded on Cboe Options in a manner that is consistent with Cboe Options' rules, OCC proposes to amend its definition of "flexibly structured option" in Article I of its By-Laws by deleting "(other than a series of quarterly options or short term options)" in the two instances in which it appears in the definition.¹² OCC added this text to its definition of a flexibly structured option in 2009 to ensure consistency with Cboe Options rules, which were amended at that time to, among other things, allow for flexibly structured options to become fungible with subsequently introduced non-flexibly structured options series that have the same terms (other than a series of quarterly options or short term options).¹³ Consistent with Cboe Options' rule change at that time, OCC amended its definition of flexibly structured options in 2009 to provide that a flexibly structured option cannot have the same terms as

¹¹ See Securities Exchange Act Release No. 82622 (February 2, 2018), 83 FR 5668 (February 8, 2018) (SR-CBOE-2018-008) (Notice of Filing of a Proposed Rule Change Relating to Flexibly Structured Options).

¹² OCC By-Laws, Article I., Section 1.F.(8).

¹³ See Securities Exchange Act Release No. 59675 (April 1, 2009), 74 FR 15794 (April 7, 2009) (SR-OCC-2009-05); Securities Exchange Act Release No. 59417 (February 18, 2009), 74 FR 8591 (February 25, 2009) (order approving SR-CBOE-2008-115).

any series of non-flexibly structured options previously opened for trading on the exchange other than a series of quarterly options or short term options.¹⁴ OCC intended the 2009 amended definition to clarify that a flexibly structured option could share the same terms as a non-flexibly structured quarterly or short term option series and still be considered a flexibly structured option. Consistent with Cboe Options' most recent rule change, OCC proposes to eliminate from the language of its definition of a flexibly structured option the first instance of "(other than a series of quarterly options or short term options)" to provide that a flexibly structured option cannot share the same terms as a non-flexibly structured option series that has been previously opened for trading on the exchange, including a currently-trading quarterly options or short term options series. Consistent with Cboe Options' rules, OCC believes that this change would amend the definition in a manner to make it clear that flexibly structured options cannot share the same terms as non-flexibly structured option series that have been previously opened for trading on the exchange.

The second instance of "(other than a series of quarterly options or short term options)" in the flexibly structured option definition was adopted in 2009 to provide, consistent with Cboe Options rules then in effect and as an exception to general fungibility, that a quarterly options or short term options series with the same terms as a flexibly structured option would not become fungible with that flexibly structured option. As noted above, Cboe Options has recently adopted a rule change to eliminate this

¹⁴ See Securities Exchange Act Release No. 59060 (December 5, 2008), 73 FR 76075 (December 15, 2008) (SR-CBOE-2008-115) ("subject to certain aggregation requirements for cash settled options, the current FLEX Rules do permit the expiration of FLEX Options on the same day that Non-FLEX quarterly index options ("QIX") and Non-FLEX Weekly Options expire.").

restriction and allow all flexibly structured options to become fungible with non-flexibly structured options series having identical variable terms that are later opened for trading on the exchange.¹⁵ Accordingly, OCC proposes to eliminate the second instance of this text from the language of the definition of a flexibly structured option in OCC's By-Laws to make it consistent with Cboe Options' rules. As amended, OCC's definition of a flexibly structured option would provide that once a series of non-flexibly structured options is opened for trading on an exchange, any existing flexibly structured option contracts that have identical variable terms shall be fully fungible with options in such series, and shall cease to be flexibly structured options. OCC believes that this change would allow OCC clear and settle flexibly structured options traded on Cboe Options in a manner that is consistent with Cboe Options' rules and would have the effect of making more flexibly structured options fungible with identical non-flexibly structured options series.

(2) Statutory Basis

Section 17A(b)(3)(F) of the Securities Exchange Act of 1934, as amended ("Act")¹⁶ requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities and derivatives transactions, to foster cooperation and coordination with persons engaged in clearance and settlement, and, in general, to protect investors and the public interest. OCC believes that the proposed rule change is consistent with Section 17A(b)(3)(F) of Act¹⁷ because it

¹⁵ See supra note 9.

¹⁶ 15 U.S.C. 78q-1(b)(3)(F).

¹⁷ 15 U.S.C. 78q-1(b)(3)(F).

is designed to promote the prompt and accurate clearance and settlement of securities transactions in flexibly structured options. The proposed rule change accomplishes this by maintaining consistency between OCC's By-Laws and Rules and Cboe Options' rules as applied to the clearance and settlement of flexibly structured options. OCC further believes that the proposed rule change accomplishes this by providing that all flexibly structured options are subject to the same requirements. The proposed rule change would make all flexibly structured options fungible with subsequently introduced non-flexibly structured options with identical terms, thereby increasing operational efficiency by eliminating the need for OCC to monitor and treat a certain group of flexibly structured options (i.e. ones with the same terms as quarterly options and short term options series) differently than other flexibly structured options. In addition, Cboe Options has noted that its rule change will potentially increase the liquidity available to traders of flexibly structured options.¹⁸ Moreover, the Commission has previously noted that it would be concerned if flexibly structured options were to act as a surrogate for trading in standardized options (i.e., non-flexibly structured exchange-traded options) and that allowing for flexibly structured options to become fungible with standardized options would help alleviate this concern.¹⁹ In this respect, the Commission noted the following when it initially approved Cboe Options' rules to provide for fungibility between flexibly structured options and standardized options series with the same terms:

However, the rules, as proposed by the CBOE, help to ensure that FLEX market participants cannot avoid the protections provided to retail investors in the standardized options market simply by trading FLEX Options. In this regard,

¹⁸ See supra note 10.

¹⁹ See Securities Exchange Act Release No. 59417 (February 18, 2009), 74 FR 8591 (February 25, 2009) (order approving SR-CBOE-2008-115). See also supra note 9.

once a series is open for trading, new FLEX Options are not permitted in that series. In addition, once a Non-FLEX Options series is open, all outstanding FLEX Options in the same series become fungible with the standardized market, are traded pursuant to standardized market trading rules, and are aggregated for position and exercise limit purposes. These rules help to alleviate these surrogate concerns and should help to ensure that FLEX Options market continues to operate as intended.²⁰

The proposed rule change would help to further address this concern by allowing all flexibly structured options to become fungible with non-flexibly structured options series with the same terms that are later opened for trading on the exchange.

In addition, the proposed rule change is not inconsistent with the existing By-Laws and Rules of OCC, including any rules proposed to be amended.

(B) Clearing Agency's Statement on Burden on Competition

Section 17A(b)(3)(I) of the Act²¹ requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the Act. OCC does not believe that the proposed rule change would impact or impose any burden on competition.²² The proposed rule change would not affect the competitive dynamics between clearing members, but rather would solely affect the treatment of flexibly structured options with the same terms as quarterly options and short term options series. In this respect, it would facilitate consistent treatment of such flexibly structured options with all other flexibly structured options, providing that all flexibly structured options will become fungible with subsequently-introduced standardized options with the same terms. The proposed rule change also would not inhibit access to OCC's services or

²⁰ See Securities Exchange Act Release No. 59417 (February 18, 2009), 74 FR 8591 (February 25, 2009) (order approving SR-CBOE-2008-115).

²¹ 15 U.S.C. 78q-1(b)(3)(I).

²² 15 U.S.C. 78q-1(b)(3)(I).

disadvantage or favor any particular user in relationship to another. The proposed rule change would treat equally all holders of flexibly structured options with the same terms as subsequently introduced quarterly options and short term options series, providing that such flexibly structured options held by them would become fungible with such standardized options series. For the foregoing reasons, OCC believes the proposed rule change is in the public interest, would be consistent with the requirements of the Act applicable to clearing agencies, and would not impact or impose a burden on competition.

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments on the proposed rule change were not and are not intended to be solicited with respect to the proposed rule change and none have been received.

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act²³ and Rule 19b-4(f)(4)(ii)²⁴ thereunder because it effects a change in an existing service that (i) does not adversely affect the safeguarding of securities or funds in the custody or control of the clearing agency or for which it is responsible and (ii) does not significantly affect the respective rights or obligations of the clearing agency or persons using the service.

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

²³ 15 U.S.C. 78s(b)(3)(A).

²⁴ 17 CFR 240.19b-4(f)(4)(ii).

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.²⁵

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-OCC-2018-010 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-OCC-2018-010. 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

²⁵ Notwithstanding the foregoing, implementation of this rule change will be delayed until this rule change is deemed certified under CFTC Regulation §40.6.

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 OCC and on OCC's website at https://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_18_010.pdf.

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-OCC-2018-010 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.²⁶

Robert W. Errett
Deputy Secretary

²⁶ 17 CFR 200.30-3(a)(12).