

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-85628; File No. SR-NYSEAMER-2018-39)

April 11, 2019

Self-Regulatory Organizations; NYSE American LLC; Notice of Filing of Amendment No. 2 to Proposed Rule Change To Allow Flexible Exchange Equity Options To Be Cash Settled Where the Underlying Security is a Specified Exchange-Traded Fund

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 September 20, 2018, NYSE American LLC (“NYSE American ” 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 proposed rule change was published for comment in the Federal Register on October 11, 2018.<sup>3</sup> On November 19, 2018, pursuant to Section 19(b)(2) of the Act,<sup>4</sup> the Commission designated a longer period within which to either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.<sup>5</sup> The Commission received one comment letter on the proposed rule change.<sup>6</sup>

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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> See Securities Exchange Act Release No. 84364 (October 4, 2018), 83 FR 51535 (October 11, 2018) (“Notice”).

<sup>4</sup> 15 U.S.C. 78s(b)(2).

<sup>5</sup> See Securities Exchange Act Release No. 84616 (November 19, 2018), 83 FR 60519 (November 26, 2018). The Commission designated January 9, 2019, as the date by which it should approve, disapprove, or institute proceedings to determine whether to disapprove the proposed rule change.

<sup>6</sup> See Letter to Brent J. Fields, Secretary, Commission, from Samara Cohen, Head of ETF Global Markets, BlackRock, dated November 27, 2018.

On December 19, 2018, the Commission instituted proceedings under Section 19(b)(2)(B) of the Act<sup>7</sup> to determine whether to approve or disapprove the proposed rule change.<sup>8</sup> On March 11, 2019, the Exchange filed Amendment No. 1 to the proposed rule change. On March 25, 2019, the Exchange withdrew Amendment No. 1 and filed Amendment No. 2 to the proposed rule change, which superseded and replaced the proposed rule change in its entirety. On April 5, 2019, the Commission extended the time period for approving or disapproving the proposal for an additional 60 days until June 8, 2019.<sup>9</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as modified by Amendment No. 2, from interested persons.<sup>10</sup>

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. This Amendment No. 2 supersedes the original filing and the Partial Amendment No. 1

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<sup>7</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>8</sup> See Securities Exchange Act Release No. 84870 (December 19, 2018), 83 FR 66779 (December 27, 2018) (“Order Instituting Proceedings”).

<sup>9</sup> See Securities Exchange Act Release No. 85531 (April 5, 2019).

<sup>10</sup> In Amendment No. 2, the Exchange revised the proposal to limit the ETFs that could serve as an underlying security for cash-settled FLEX Equity Options to 25 enumerated ETFs, rather than all ETFs included in the Option Penny Pilot. In addition, Amendment No. 2 amended the proposal to, among other things, (1) describe characteristics of ETFs, including the calculation of net asset value, the creation and redemption mechanism, and their reliance on arbitrage; (2) provide trading data related to the 25 specified ETFs proposed to serve as the allowable underlying securities for cash-settled FLEX Equity Options; (3) describe the requirement in Rule 906G(b) that members or member organizations may be required to provide a report of positions on the same side of the market in excess of the level established as the position limit for non-FLEX Equity options of the same class; (4) describe in more detail existing surveillance procedures relevant to cash-settled FLEX Equity Options on the specified ETFs; and (5) make additional arguments about why the Exchange believes that cash settlement would be appropriate for such options.

in its entirety.<sup>11</sup> 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.

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

1. Purpose

FLEX Options are customized equity or index contracts that allow investors to tailor contract terms for exchange-listed equity and index options. The Exchange seeks to amend NYSE American Rule 903G(c) to allow for cash settlement for certain FLEX Equity Options.<sup>12</sup> As proposed, FLEX Equity Options where the underlying security is one of 25 enumerated Exchange-Traded Funds (“ETFs”) would be capable of being settled by physical delivery of the underlying ETF or by delivery in cash. Currently, all FLEX Equity Options are settled by

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<sup>11</sup> The original proposal was filed by the Exchange on September 18, 2018. See Securities Exchange Act Release No. 84364 (October 4, 2018), 83 FR 51535 (October 11, 2018). The Exchange filed Partial Amendment No. 1 on March 11, 2019 and withdrew it on March 25, 2019.

<sup>12</sup> A “FLEX Equity Option” is an option on a specified underlying equity security that is subject to the rules of Section 15. See NYSE American Rule 900G(b)(10).

physical delivery of the underlying security.<sup>13</sup> All FLEX Index Options, however, are currently settled by delivery in cash.<sup>14</sup>

To effectuate this change, the Exchange proposes new paragraph (c)(3)(ii) to Rule 903G, which would provide that the exercise settlement for a FLEX ETF Option with an underlying security listed in proposed Commentary .02 would be by physical delivery of the underlying security or by delivery in cash.<sup>15</sup> The Exchange further proposes new Commentary .02, which would provide the name and symbol of each of 25 ETFs listed in the table below.<sup>16</sup> The Exchange believes it is appropriate to introduce cash-settlement as an alternative to this group of equity securities because ETFs generally have increasingly become a major part of investors' portfolio. The vast proliferation of ETFs has greatly expanded the ability of investors to take advantage of many unique opportunities to hedge their portfolio and manage risk. Investors can take long and/or short positions - as well as in many cases, leveraged long or short positions - in baskets of securities whose components can include foreign and domestic stock indexes, currencies, commodities and bonds. Over the years, ETFs have also attracted a great deal of options trading.

As described more fully below, the Exchange believes that the deep liquidity and robust trading activity in the 25 ETFs proposed to be eligible for cash-settled FLEX ETF Options would mitigate against concerns that their settlement value would be susceptible to manipulation.

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<sup>13</sup> See Rule 903G(c)(3)(i).

<sup>14</sup> See Rule 903G(b)(2) and (3).

<sup>15</sup> See proposed Rule 903G(c)(3)(ii). The Exchange also proposes a non-substantive amendment to Rule 903G to renumber current Rule 903G(c)(3)(ii) as new Rule 903G(c)(3)(iii).

<sup>16</sup> See proposed Rule 903G, Commentary .02

## Characteristics of ETFs

ETFs are funds that have their value derived from assets owned. The net asset value (“NAV”) of an ETF is a daily calculation that is based off the most recent closing prices of the assets in the fund and an actual accounting of the total cash in the fund at the time of calculation. The NAV of an ETF is calculated by taking the sum of the assets in the fund, including any securities and cash, subtracting out any liabilities, and dividing that by the number of shares outstanding.

Additionally, each ETF is subject to a creation and redemption mechanism to ensure the price of the ETF does not fluctuate too far away from its NAV -- which mechanisms reduce the potential for manipulative activity. Each business day, ETFs are required to make publicly available a portfolio composition file that describes the makeup of their creation and redemption “baskets” (i.e., a specific list of names and quantities of securities or other assets designed to track the performance of the portfolio as a whole). ETF shares are created when an Authorized Participant, typically a market maker or other large institutional investor, deposits the daily creation basket or cash with the ETF issuer. In return for the creation basket or cash (or both), the ETF issues to the Authorized Participant a “creation unit” that consists of a specified number of ETF shares. For instance, IWM is designed to track the performance of the Russell 2000 Index. An Authorized Participant will purchase all the Russell 2000 constituent securities in the exact same weight as the index prescribes, then deliver those shares to the ETF issuer. In exchange, the ETF issuer gives the Authorized Participant a block of equally valued ETF shares, on a one-for-one fair value basis. This process can also work in reverse. A redemption is achieved when the Authorized Participant accumulates a sufficient number of shares of the ETF

to constitute a creation unit and then exchanges these ETF shares with the ETF issuer, thereby decreasing the supply of ETF shares in the market.

The principal, and perhaps most important, feature of ETFs is their reliance on an “arbitrage function” performed by market participants that influences the supply and demand of ETF shares and, thus, trading prices relative to NAV. As noted above, new ETF shares can be created and existing shares redeemed based on investor demand; thus, ETF supply is open-ended. This arbitrage function helps to keep an ETF’s price in line with the value of its underlying portfolio, i.e., it minimizes deviation from NAV. Generally, the higher the liquidity and trading volume of an ETF, the more likely the price of the ETF will not deviate from the value of its underlying portfolio and such ETFs are less susceptible to price manipulation.

#### Trading data for the 25 ETFs proposed for potential cash settlement

As illustrated in the table below, the average deviation of the closing price of the 25 ETFs from its NAV, on a percentage basis, is less than 1%. The close proximity between each ETF’s NAV and its closing price illustrates how closely the 25 ETFs selected by the Exchange are tethered to values beyond buying and selling at the close. More specifically, the ETFs that underlie options subject to this proposal are highly liquid, and are based on a broad set of highly liquid securities. The table below presents descriptive statistics for the 25 ETFs selected by the Exchange, as of December 31, 2018, and includes, for each ETF: the 20-day average trading volume of the underlying ETF (in shares and dollar value), the assets under management, the average deviation from net asset value, and the average daily volume of options contracts traded overlying each ETF.

ETF	ETF Ticker	20-day Average Trading Volume (Shares)	20-day Average Trading Volume (\$)	Total Fund Assets Under Management (\$)	Average Deviation from Net Asset Value (NAV)	Options Average Daily Volume
SPDR S&P 500 ETF	SPY	160,041,302	40,948,098,000	240,106.44	0.02%	4,611,460
Invesco Nasdaq 100 ETF	QQQ	71,613,353	11,310,618,350	61,145.94	0.03%	1,108,432
iShares MSCI Emerging Markets ETF	EEM	111,792,871	4,439,674,650	29,314.21	0.54%	585,794
iShares Russell 2000 ETF	IWM	35,158,745	4,861,054,750	39,907.42	0.41%	510,309
iShares iBoxx \$ High Yield Corporate Bond ETF	HYG	27,488,196	2,250,963,000	13,202.49	0.23%	345,034
SPDR S&P Oil & Gas Exploration & Production ETF	XOP	27,040,448	784,296,775	2,406.98	0.07%	223,594
iShares China Large-Cap ETF	FXI	41,125,843	1,668,342,775	5,671.99	0.70%	216,003
Financial Select Sector SPDR ETF	XLF	90,744,549	2,206,780,250	22,899.77	0.04%	209,185

iShares MSCI EAFE ETF	EFA	61,226,608	3,656,868,050	62,279.02	0.28%	188,666
iShares MSCI Brazil ETF	EWZ	26,957,238	1,032,776,750	7,694.70	0.65%	180,654
iShares 20+ Year Treasury Bond ETF	TLT	11,423,906	1,364,567,990	8,761.36	0.11%	123,591
SPDR S&P Regional Banking ETF	KRE	12,780,929	625,733,560	2,926.33	0.05%	95,607
VanEck Vectors Gold Miners ETF	GDV	61,166,478	1,248,025,595	10,575.69	0.16%	90,602
SPDR Dow Jones Industrial Average ETF	DIA	6,985,256	1,660,420,135	19,700.41	0.02%	83,202
SPDR S&P Biotech ETF	XBI	7,488,285	554,592,040	3,608.90	0.10%	62,290
Energy Select Sector SPDR ETF	XLE	24,766,279	1,502,959,710	13,431.16	0.04%	57,398
Utilities Select Sector SPDR ETF	XLU	24,430,265	1,339,179,575	8,383.96	0.04%	50,759
Consumer Staples Select Sector SPDR ETF	XLP	27,738,596	1,469,257,995	9,572.95	0.04%	28,699

iShares U.S. Real Estate ETF	IYR	11,283,934	881,610,765	3,434.70	0.07%	26,722
Technology Select Sector SPDR ETF	XLK	22,235,286	1,407,316,770	17,305.90	0.03%	21,243
Industrial Select Sector SPDR ETF	XLI	19,012,293	1,269,902,155	9,689.46	0.04%	20,789
Healthcare Select Sector ETF	XLV	17,397,161	1,529,979,575	17,987.48	0.04%	20,183
iShares MSCI Japan ETF	EWJ	17,714,960	921,963,790	15,253.86	0.46%	13,855
Materials Select Sector SPDR ETF	XLB	12,685,383	646,247,535	3,634.08	0.04%	11,552
VanEck Vectors Junior Gold Miners ETF	GDXJ	14,662,291	419,654,120	4,273.40	0.23%	10,868

As illustrated in the table above, each of the 25 ETFs is actively traded and highly liquid and thus not readily susceptible to manipulation for the following reasons:

- First, each has a 20-day ADV of at least 7 million shares which indicates substantial liquidity present in the trading of these securities.
- Second, each ETF has a notional value over that 20-day period of at least \$400 million which implies that the ETF has significant depth and breadth of market participants providing liquidity.

- Third, each ETF has a minimum of \$2 billion of assets under management which demonstrates broad ownership as well as depth and breadth of investor interest.
- Finally, each ETF has an ADV of at least 10,000 options contracts which indicates that there is significant quoting and trading interest in the options overlying each ETF.

The Exchange believes that this data indicates that permitting cash settlement as a FLEX term for the 25 ETFs selected by the Exchange would broaden the base of investors that use FLEX Options to manage their trading and investment risk, including investors that currently trade in the OTC market for customized options, where settlement restrictions do not apply. Moreover, introducing cash settlement as a FLEX term for these 25 ETFs would be appropriate because the data above indicates that these are some of the most actively traded and liquid ETFs and are therefore not readily susceptible to manipulation.

Today, all ETF options are settled physically, i.e., upon exercise, shares of the underlying ETF must be assumed or delivered. Physical settlement possesses certain risks with respect to volatility and movement of the underlying security at expiration that market participants may need to hedge against. Cash settlement may be preferable to physical delivery in some circumstances as it does not present the same risk. If an issue with the delivery of the underlying security arises, it may become more expensive (and time consuming) to reverse the delivery because the price of the underlying security would almost certainly have changed. Reversing a cash payment, on the other hand, would not involve any such issue because reversing a cash delivery would simply involve the exchange of cash. Additionally, with physical settlement, market participants that have a need to generate cash would have to sell the underlying security while incurring the costs associated with liquidating their position in the underlying security as well as the risk of an adverse movement in the price of the underlying security. The Exchange

notes that cash settlement for options is not a unique feature and other options exchanges currently trade cash-settled options.<sup>17</sup>

The Exchange understands that there are concerns that have been raised in the past regarding cash-settled equity options. The Exchange seeks to allay such concerns by proposing to adopt cash-settlement as an alternative to ETFs only, and more specifically, to a narrow universe of 25 ETFs. As a general matter, all index options traded today are cash-settled and derive their value from a disseminated index price. Similarly, ETFs typically have their values linked to a disseminated index price. As noted above, the Exchange seeks to limit cash-settlement to 25 of the most liquid and actively traded ETFs, as evidenced by the data underlying the 25 ETFs in the table above.

With respect to position limits, cash-settled FLEX ETF Options would be subject to the position limits set forth in Rule 906G. Accordingly, the Exchange would establish position limits for cash-settled FLEX ETF Options that are the same as non-cash-settled FLEX ETF Options. Pursuant to Rule 906G(b), each member or member organization (other than a Specialist or Floor Market Maker) that maintains a position on the same side of the market in excess of the level established pursuant to Rule 904 for Non-FLEX Equity options of the same class on behalf of its own account or for the account of a customer is required to report to the Exchange information on the FLEX Equity option position, positions in any related instrument, the purpose or strategy for the position and the collateral used by the account.

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<sup>17</sup> See e.g. PHLX FX Options traded on Nasdaq PHLX and S&P 500® Index Options traded on Cboe Options Exchange. More recently, the Commission approved, on a pilot basis, the listing and trading of RealDay™ Options on the BOX Options Exchange LLC. See Securities Exchange Act Release No. 79936 (February 2, 2017), 82 FR 9886 (February 8, 2017) (“RealDay Pilot Program”). The RealDay Pilot Program has been extended until February 2, 2019. See Securities Exchange Act Release No. 82414 (December 28, 2017), 83 FR 577 (January 4, 2018) (SR-BOX-2017-38).

The Exchange understands that FLEX ETF Options are currently traded in the over-the-counter (“OTC”) market by a variety of market participants, e.g., hedge funds, proprietary trading firms, and pension funds, to name a few. The Exchange believes there is room for significant growth if a comparable product were introduced for trading on a regulated market. The Exchange expects that users of these OTC products would be among the primary users of exchange-traded cash-settled FLEX ETF Options. The Exchange also believes that the trading of cash-settled FLEX ETF Options would allow these same market participants to better manage the risk associated with the volatility of underlying ETF positions given the enhanced liquidity that an exchange-traded product would bring.

Cash-settled FLEX ETF Options traded on the Exchange would have three important advantages over the contracts that are traded in the OTC market. First, as a result of greater standardization of contract terms, exchange-traded contracts should develop more liquidity. Second, counter-party credit risk would be mitigated by the fact that the contracts are issued and guaranteed by The Options Clearing Corporation (“OCC”). Finally, the price discovery and dissemination provided by the Exchange and its members would lead to more transparent markets. The Exchange believes that its ability to offer cash-settled FLEX ETF Options would aid it in competing with the OTC market and at the same time expand the universe of products available to interested market participants. The Exchange believes that an exchange-traded alternative may provide a useful risk management and trading vehicle for market participants and their customers.

The Exchange has confirmed with the OCC that OCC can support the clearance and settlement of cash-settled FLEX ETF Options. The Exchange has analyzed its capacity and represents that it believes the Exchange and OPRA have the necessary systems capacity to

handle the additional traffic associated with the listing of cash-settled FLEX ETF Options. The Exchange believes any additional traffic that would be generated from the introduction of cash-settled FLEX ETF Options would be manageable. The Exchange believes ATP Holders will not have a capacity issue as a result of this proposed rule change. The Exchange also represents that it does not believe this proposed rule change will cause fragmentation of liquidity. The Exchange will monitor the trading volume associated with the additional options series listed as a result of this proposed rule change and the effect (if any) of these additional series on market fragmentation and on the capacity of the Exchange's automated systems.

The Exchange has an adequate surveillance program in place for cash-settled FLEX ETF Options and intends to apply the same program procedures that it applies to the Exchange's other options products. FLEX options products and their respective symbols are integrated into the Exchange's existing surveillance system architecture and are thus subject to the relevant surveillance processes. As a result, the Exchange believes it would be able to effectively police the trading of cash-settled FLEX ETF Options using means that include its surveillance for manipulation. The Exchange believes that manipulating the settlement price of cash-settled FLEX ETF Options would be difficult based on the size of the market for the 25 ETFs that are the subject of this proposed rule change. Additionally, the Exchange notes that each cash-settled FLEX ETF Option that would be subject to this proposed rule change is sufficiently active so as to alleviate concerns about potential manipulative activity. Further, the vast liquidity of the 25 ETF options as well as the underlying equities markets ensures a multitude of market participants at any given time. Given the high level of participation among market participants that enter quotes and/or orders in these ETF options, the Exchange believes it would be very difficult for a single participant to alter the prices of each of the underlying securities of an ETF in any

significant way without exposing the would-be manipulator to regulatory scrutiny. The Exchange further believes any attempt to manipulate the prices of the underlying securities of an ETF would also be cost prohibitive.

With respect to regulatory scrutiny, the Exchange further believes its existing surveillance technologies and procedures adequately address potential concerns regarding possible manipulation of the settlement value at or near the close of the market. The Exchange notes that the regulatory program operated by and overseen by NYSE Regulation includes cross-market surveillance designed to identify manipulative and other improper trading, including spoofing, algorithm gaming, marking the close and open, as well as more general, abusive behavior related to front running, wash sales, quoting/routing, and Reg SHO violations, that may occur on the Exchange and other markets. These cross-market patterns incorporate relevant data from various markets beyond the Exchange and its affiliates, including data from NYSE Arca, Inc. and from markets not affiliated with the Exchange. The Exchange represents that its existing trading surveillances are adequate to monitor the trading in the underlying ETF and subsequent trading of options on those ETFs on the Exchange.<sup>18</sup>

Additionally, for options, the Exchange utilizes an array of patterns that monitor manipulation of options, or manipulation of equity securities (regardless of venue) for the purpose of impacting options prices on the Exchange (i.e., mini-manipulation strategies). That surveillance coverage is initiated once options begin trading on the Exchange. Accordingly, the Exchange believes that the cross-market surveillance performed by the Exchange or FINRA on

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<sup>18</sup> Such surveillance procedures generally focus on detecting securities trading subject to opening price manipulation, closing price manipulation, layering, spoofing or other unlawful activity impacting an underlying security, the option, or both. The Exchange has price movement alerts, unusual market activity and order book alerts active for all trading symbols.

behalf of the Exchange, coupled with NYSE Regulation's own monitoring for violative activity on the Exchange comprise a comprehensive surveillance program that is adequate to monitor for manipulation of the underlying security and overlying option. Furthermore, the Exchange believes that the existing surveillance procedures at the Exchange are capable of properly identifying unusual and/or illegal trading activity, which the Exchange would utilize to surveil for aberrant trading in cash-settled FLEX ETF Options. Finally, the Exchange notes that routine oversight inspections of the Exchange's regulatory programs by the Commission have not uncovered any material inconsistencies or shortcomings in the manner in which the Exchange's market surveillance is conducted.

The Exchange does not believe that allowing cash settlement as a contract term would render the marketplace for equity options more susceptible to manipulative practices. In addition to the surveillance procedures and processes described above, improvements in audit trails, recordkeeping practices, and inter-exchange cooperation over the last two decades have greatly increased the Exchange's ability to detect and punish attempted manipulative activities. The Exchange therefore believes that the decision of whether or not to allow cash settlement as a contract term for the proposed 25 FLEX ETF Options should rest on the ability of the Exchange to monitor and detect manipulative activity, not on any perceived threat of increased attempted manipulative activity.

Additionally, the Exchange is a member of the Intermarket Surveillance Group ("ISG") under the Intermarket Surveillance Group Agreement dated June 20, 1994. The ISG members work together to coordinate surveillance and investigative information sharing in the stock and options markets. For surveillance purposes, the Exchange would therefore have access to information regarding trading activity in the pertinent underlying securities.

The proposed rule change is designed to allow investors seeking to effect cash-settled FLEX ETF Options with the opportunity for a different method of settling option contracts at expiration if they choose to do so. As noted above, market participants may choose cash settlement because physical settlement possesses certain risks with respect to volatility and movement of the underlying security at expiration that market participants may need to hedge against. The Exchange believes that offering innovative products flows to the benefit of the investing public. A robust and competitive market requires that exchanges respond to member's evolving needs by constantly improving their offerings. Such efforts would be stymied if exchanges were prohibited from offering innovative products for reasons that are generally debated in academic literature. The Exchange believes that introducing cash-settled FLEX ETF Options would further broaden the base of investors that use FLEX Options to manage their trading and investment risk, including investors that currently trade in the OTC markets for customized options, where settlement restrictions do not apply. The proposed rule change is also designed to encourage market makers to shift liquidity from OTC markets onto the Exchange, which, it believes, will enhance the process of price discovery conducted on the Exchange through increased order flow. The Exchange also believes that this may open up cash-settled FLEX ETF Options to more retail investors. The Exchange does not believe that this proposed rule change raises any unique regulatory concerns because existing safeguards—such as position limits, exercise limits, and reporting requirements—would continue to apply.

## 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>19</sup> in general, and furthers the objectives of Section 6(b)(5) of

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<sup>19</sup> 15 U.S.C. 78f(b).

the Act,<sup>20</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. Specifically, the Exchange believes that introducing cash-settled FLEX ETF Options will increase order flow to the Exchange, increase the variety of options products available for trading, and provide a valuable tool for investors to manage risk.

The Exchange believes that the proposal to permit cash settlement as a contract term for the proposed 25 FLEX ETF Options would remove impediments to and perfect the mechanism of a free and open market as cash-settled FLEX ETF Options would enable market participants to receive cash in lieu of shares of the underlying security, which would, in turn provide greater opportunities for market participants to manage risk through the use of cash-settled FLEX ETF Options to the benefit of investors and the public interest. The Exchange does not believe that allowing cash settlement as a contract term for the proposed 25 FLEX ETF Options would render the marketplace for equity options more susceptible to manipulative practices. As illustrated in the table above, each of the 25 ETFs is actively traded and highly liquid and thus not susceptible to manipulation for the following reasons. First, each ETF has a 20-day ADV of at least 7 million shares which indicates substantial liquidity present in the trading of these securities. Second, each ETF has a notional value over that 20-day period of at least \$400 million which implies that the ETF has significant depth and breadth of market participants providing liquidity. Third, each ETF has a minimum of \$2 billion of assets under management which demonstrates broad ownership as well as depth and breadth of investor interest. And

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<sup>20</sup> 15 U.S.C. 78f(b)(5).

finally, each ETF has an ADV of at least 10,000 options contracts which indicates that there is significant quoting and trading interest in the options overlying each ETF.

The Exchange believes that the data provided by the Exchange supports the supposition that permitting cash settlement as a FLEX term for the 25 ETFs selected by the Exchange would broaden the base of investors that use FLEX Options to manage their trading and investment risk, including investors that currently trade in the OTC market for customized options, where settlement restrictions do not apply.

The Exchange believes that the proposal to permit cash settlement would remove impediments to and perfect the mechanism of a free and open market because the proposed rule change would provide ATP Holders with enhanced methods to manage risk by receiving cash if they choose to do so instead of the underlying security. In addition, this proposal would promote just and equitable principles of trade and protect investors and the general public because cash settlement would provide investors with an additional tool to manage their risk. Further, the Exchange notes that its proposal to introduce cash-settled FLEX ETF Options is not novel in that other exchanges currently offer [sic] cash settlement for options whose underlying security is an ETF. The proposed rule change therefore should not raise any issues for the Commission that have not been previously addressed.<sup>21</sup>

The proposed rule change to permit cash settlement as a contract term for the 25 FLEX ETF Options is designed to promote just and equitable principles of trade in that the availability of cash settlement as a contract term would give market participants an alternative to trading similar products in the OTC market. By trading a product in an exchange-traded environment (that is currently being used in the OTC market), the Exchange would be able to compete more

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<sup>21</sup> See supra note 17.

effectively with the OTC market. The Exchange believes the proposed rule change is designed to prevent fraudulent and manipulative acts and practices in that it would lead to the migration of options currently trading in the OTC market to trading to the Exchange. Also, any migration to the Exchange from the OTC market would result in increased market transparency.

Additionally, the Exchange believes the proposed rule change is designed to remove impediments to and to perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest in that it should create greater trading and hedging opportunities and flexibility. The proposed rule change should also result in enhanced efficiency in initiating and closing out positions and heightened contra-party creditworthiness due to the role of OCC as issuer and guarantor of cash-settled FLEX ETF Options. Further, the proposed rule change would result in increased competition by permitting the Exchange to offer products that are currently used in the OTC market.

Finally, the Exchange represents that it has an adequate surveillance program in place to detect manipulative trading in cash-settled FLEX ETF Options. Regarding the proposed cash settlement, the Exchange would use the same surveillance procedures currently utilized for the Exchange's other FLEX Options. For surveillance purposes, the Exchange would have access to information regarding trading activity in the pertinent underlying securities. The Exchange believes that limiting cash settlement to FLEX ETF Options would minimize the possibility of manipulation due to the robust liquidity in both the ETF and options markets.

**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 cash-settled FLEX ETF Option orders with the opportunity for different methods of settling option contracts at expiration.

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 believes the proposed rule change encourages competition amongst market participants to provide tailored cash-settled FLEX ETF Option 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. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as modified by Amendment No. 2, 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-NYSEAMER-2018-39 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-NYSEAMER-2018-39. 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 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. 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-NYSEAMER-2018-39, 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>22</sup>

Eduardo A. Aleman  
Deputy Secretary

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<sup>22</sup> 17 CFR 200.30-3(a)(12).