

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72536; File No. SR-NYSEMKT-2014-21)

July 3, 2014

Self-Regulatory Organizations; NYSE MKT LLC; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 1, to Make Permanent Its Pilot Program Regarding Minimum Value Sizes for Opening Transactions in New Series of Flexible Exchange Options and Establish New Minimum Value Sizes Applicable to Other FLEX Transactions and FLEX Quotes

I. Introduction

On March 18, 2014, NYSE MKT LLC (the “Exchange” or “NYSE MKT”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to make permanent its pilot program regarding minimum value sizes for opening transactions in new series of flexible exchange options (“FLEX Options” or “FLEX”) and establish new minimum value sizes applicable to other FLEX transactions and FLEX Quotes. The proposed rule change was published for comment in the Federal Register on April 7, 2014.³ The Commission received no comments on the proposal. The Exchange consented to an extension of the time period for the Commission to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether the proposed rule change should be disapproved, to July 6, 2014. The Exchange filed Amendment No. 1 to the proposed rule change on May 22, 2014, in order to transmit a revised pilot report that replaces the original

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 71840 (April 1, 2014), 79 FR 19162 (“Notice”).

Exhibit 3 to the filing.⁴ The Commission is publishing this notice to solicit comments on Amendment No. 1 from interested persons and is approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

II. Description of the Amended Proposal

FLEX Options, unlike traditional standardized options, allow investors to customize basic option terms, including size, expiration date, exercise style, and certain exercise prices.⁵

Pursuant to Commentary .01 to Rule 903G, the Exchange currently has in place a pilot program under which the minimum size requirements set forth in Rule 903G(a)(4)(ii), which apply to opening transactions in new series of FLEX Options, are replaced with a one-contract minimum size (“Pilot Program”).⁶ Prior to the Pilot Program, pursuant to Rule 903G(a)(4)(ii), the minimum value size for an opening transaction in any FLEX series in which there was no open

⁴ The Exchange attached an Exhibit 3 to its proposed rule change that contained an annual report summarizing pilot data collected for the year 2013, the most recent complete year of the pilot program (“Pilot Report”). Specifically, the Pilot Report summarizes the trading volume and underlying value of opening transactions in new series of FLEX Options during the year 2013 with a size below the minimum value thresholds in force before the pilot, as well as the types of customers initiating such transactions. In Amendment No. 1, the Exchange submitted a revised Pilot Report as a new Exhibit 3 that replaces the original Exhibit 3 in its entirety. The revised Pilot Report corrects errors in the total FLEX Equity Option contract trading volume under the pilot, total FLEX Index Option contract trading volume under the pilot, and total number of FLEX Index Option trades under the pilot reported in the original Pilot Report. The revised Pilot Report also makes corresponding adjustments to other figures reported in the Pilot Report, as well as non-substantive changes to certain descriptive language in the Pilot Report.

⁵ See Notice, 79 FR at 19162 n.4; see also NYSE MKT Options Rule (“Rule”) 903G. FLEX Options can be FLEX Index Options or FLEX Equity Options. See Rules 900G(b)(10) and (b)(11) (defining, respectively, the terms “FLEX Equity Option” and “FLEX Index Option”).

⁶ See Commentary .01 to Rule 903G; see also Securities Exchange Act Release No. 62084 (May 12, 2010), 75 FR 28091 (May 19, 2010) (SR-NYSEAmex-2010-40) (establishing Pilot Program); and 71844 (April 1, 2014), 79 FR 19160 (April 7, 2014) (SR-NYSEMKT-2014-26) (extending Pilot Program until the earlier of July 31, 2014 or approval of the Pilot Program on a permanent basis).

interest at the time the request for quotes was submitted was: (i) for FLEX Equity Options, the lesser of 250 contracts or the number of contracts overlying \$1 million in the underlying securities; and (ii) for FLEX Index Options, \$10 million Underlying Equivalent Value in the case of Broad Stock Index Group FLEX Index Options and \$5 million Underlying Equivalent Value in the case of Stock Index Industry Group FLEX Index Options.⁷ The Exchange's proposal will make the Pilot Program permanent by eliminating the minimum value size requirements set forth in Rule 903G(a)(4)(ii) for opening transactions in new FLEX Option series and by eliminating the Pilot Program rule text set forth in Commentary .01 to Rule 903G. In connection with its proposal to make the Pilot Program permanent, and as required by its filing establishing the Pilot Program,⁸ the Exchange submitted to the Commission an annual Pilot Report summarizing Pilot Program data collected for year 2013, the most recent complete year of the Pilot Program.⁹

In its filing, the Exchange also has proposed to make some other changes to its FLEX Option minimum value size rules, in addition to requesting that the Pilot Program be made permanent. Rules 903G(a)(4)(iii)-(iv), which are not part of the Pilot Program, set forth minimum value sizes for other FLEX Option transactions and for FLEX Quotes. Specifically, pursuant to Rule 903G(a)(4)(iii), for a transaction in any currently-opened FLEX series, the minimum value size is: (i) for FLEX Equity Options, the lesser of 100 contracts or the number of contracts overlying \$1 million in the underlying securities in the case of opening transactions, and 25 contracts in the case of closing transactions; and (ii) for FLEX Index Options, \$1 million

⁷ See Rule 903G(a)(4)(ii); see also Rule 900G(b)(9) (defining the term "Underlying Equivalent Value").

⁸ See supra note 6.

⁹ Specifically, the Pilot Report contains data and analysis of underlying equivalent values, open interest and trading volume, and analysis of the types of investors that initiated opening FLEX Equity and Index Options transactions (i.e., institutional, high net worth, or retail) in new FLEX Option series. See Amendment No. 1, supra note 4.

Underlying Equivalent Value in the case of both opening and closing transactions; or (iii) for either case, the remaining underlying size or Underlying Equivalent Value on a closing transaction, whichever is less. Pursuant to Rule 903G(a)(4)(iv), the minimum value size for FLEX Quotes responsive to a Request for Quotes is 25 contracts in the case of FLEX Equity Options and \$1 million Underlying Equivalent Value in the case of FLEX Index Options or for either case the remaining underlying size or Underlying Equivalent Value on a closing transaction, whichever is less. Even though these minimum value size requirements set forth in Rules 903G(a)(4)(iii)-(iv) are not part of the Pilot Program, the Exchange has proposed to eliminate them as well, in conjunction with making the Pilot Program permanent. In its proposal the Exchange noted that adopting the same minimum value sizes for existing and new series, in addition to quotes, will allow market participants to tailor their FLEX Option transactions to meet their investment objectives.

By proposing to make permanent the Pilot Program one-contract minimum for opening transactions in new series of FLEX Options and by also proposing to eliminate the minimum value size requirements for FLEX Option transactions in currently-opened series and FLEX Quotes responsive to a Request for Quotes, the Exchange is seeking to establish a one-contract minimum size for all FLEX Option transactions and FLEX Quotes. This one-contract minimum size would be codified in new Rule 903G(a)(2)(vii). The Exchange states that its proposal for a one-contract minimum value size for all FLEX Option transactions and FLEX Quotes is based on similar rules governing minimum value size for FLEX Options approved for the CBOE.¹⁰

¹⁰ See Notice, 79 FR at 19164 and n.15 (citing Securities Exchange Act Release No. 67624 (August 8, 2012), 77 FR 48580 (August 14, 2012) (order approving CBOE's proposal to make permanent its pilot program eliminating minimum value sizes for FLEX Options)).

In addition, as a technical, non-substantive change, the Exchange has proposed to relocate from current Rule 903G(a)(4)(i) to new Rule 903G(a)(2)(vi) rule text stating that the maximum term for both Equity and Index FLEX Options shall be fifteen years, and make other non-substantive changes to the rule.

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹¹ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,¹² which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and not be designed to permit unfair discrimination between customers, issuers, brokers or dealers.

FLEX Options were originally designed for use by institutional and high net worth customers, rather than retail investors.¹³ In approving CBOE's pilot eliminating minimum value

¹¹ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹² 15 U.S.C. 78f(b)(5).

¹³ See Notice, 79 FR at 19163; see also Securities Exchange Act Release No. 37336 (June 19, 1996), 61 FR 33558 (June 27, 1996) (order approving SR-Amex-95-57). As noted in the Options Disclosure Document ("ODD"), which explains the characteristics and risks of exchange-traded options, flexibly structured options may be useful to sophisticated investors seeking to manage particular portfolio and trading risks. Rule 9b-1 under the Act requires that broker-dealers furnish the ODD to a customer before accepting an order

sizes for FLEX Options, which was the first such pilot to go into effect, the Commission noted that it had received several comment letters stating that the proposal would assist institutional customers, but it also noted that the elimination of the minimum value size requirements raised the possibility that retail customers would access the FLEX Options market.¹⁴ One of the risks to retail investors outlined in the ODD¹⁵ is that, because of the customized nature of FLEX Options and lack of continuous quotes, trading in FLEX Options is often less deep and liquid than trading in standardized options on the same underlying interest.¹⁶ Additionally, the Commission observed that reducing the minimum value size for opening FLEX Option transactions increases the potential for the FLEX Options market to act as a surrogate for the standardized options market, and expressed concern in this regard because the standardized market contains certain protections for investors not present in the FLEX Options market.¹⁷ The Commission stated that, in the event CBOE proposed making its pilot program permanent, information regarding the types of customers initiating opening FLEX Options transactions

from the customer to purchase or sell an option contract relating to an options class that is the subject of the ODD, or approving the customer's account for the trading of such option. See 17 CFR 240.9b-1(d).

¹⁴ See Securities Exchange Act Release No. 61439 (January 28, 2010), 75 FR 5831 (February 4, 2010) (order approving SR-CBOE-2009-087) (“CBOE Pilot Approval Order”).

¹⁵ See supra note 13.

¹⁶ In particular, the ODD states that because many of the terms of FLEX Options are not standardized, it is less likely that there will be an active secondary market in which holders and writers of such options will be able to close out their positions by offsetting sales and purchases. Also, the ODD states that certain margin requirements for positions in flexibly structured options may be significantly greater than the margin requirements applicable to similar positions in other options on the same underlying interest.

¹⁷ See CBOE Pilot Approval Order, supra note 14. In particular, the Commission noted that continuous quotes may not always be available in the FLEX Options market and that FLEX Options do not have trading rotations at either the opening or closing of trading. Id.

during the pilot would enable the Commission to evaluate how market participants have responded to CBOE's pilot program and what types of customers are using the FLEX Options market.¹⁸ For these same reasons, at the Commission's request, the Exchange included in its Pilot Report information regarding the types of customers that initiated opening FLEX Option transactions under its Pilot Program.¹⁹

The Commission believes that these considerations and concerns that informed its analysis of whether to permanently approve CBOE's pilot are equally germane to its analysis here. As such, the Commission has carefully reviewed the Pilot Report that the Exchange provided to the Commission.²⁰ The Pilot Report reflects that, in 2013, 315 opening transactions in new series of FLEX Equity Options were initiated on the Exchange with small minimum value sizes made possible by the Pilot Program, 286 of which were initiated by retail customers, 25 of which were initiated by institutional customers, and 4 of which were initiated by high net worth customers.²¹ Moreover, the Pilot Report indicates that these 315 FLEX Equity Option transactions covered by the Pilot Program accounted for approximately 3% of the total volume and approximately 5% of the total value of all opening FLEX Equity Option transactions in new series – *i.e.*, opening transactions covered by the Pilot Program as well as opening transactions with value sizes above the pre-pilot minimum – during 2013.

¹⁸ Id. The Exchange has submitted a Pilot Report to the Commission as Exhibit 3 to its filing, as well as other, confidential reports of data collected during the Pilot Program. See Amendment No. 1, supra note 4.

¹⁹ See Amendment No. 1, supra note 4.

²⁰ Id.

²¹ Id. The Pilot Report indicates that there were no opening transactions in new series of FLEX Index Options during 2013 that were initiated below the pre-pilot minimum size requirement.

The Exchange notes that the Pilot Report includes data specific to opening transactions in new series of FLEX Options pursuant to current Rule 903G(a)(4)(ii), and does not include data for transactions in currently-opened FLEX Options series or FLEX Quotes responsive to a request for quotes pursuant to Rules 903G(a)(4)(iii)-(iv), as such transactions and FLEX Quotes were not part of the Pilot Program.²² The Exchange represents, however, that based on its internal review, if Rules 903G(a)(4)(iii)-(iv) had been part of the Pilot Program, transactions in currently-opened FLEX Options series or FLEX Quotes with small value sizes made permissible by the Pilot Program would have been de minimis, and would not have materially altered the data in the Pilot Report.²³

On balance, the Commission believes that it is consistent with the Act to make the Pilot Program permanent and thus eliminate, on a permanent basis, the minimum value size requirements set forth in Rule 903G(a)(4)(ii) for opening transactions in new series of FLEX Options. The protections noted below, including heightened options suitability requirements, should help to address any concerns about retail participation in the Exchange's FLEX Options market. Moreover, the Commission is not aware of any data or analysis to date suggesting that the trading of FLEX Options has acted as a surrogate for the trading of standardized options on the Exchange as a result of the Pilot Program. Indeed, the Commission understands that FLEX Option trading accounts for less than 1% of the combined trading volume of the standardized and FLEX Option markets.²⁴ In addition, the Pilot Report indicates that Pilot Program FLEX Option trades account for a very small proportion of the total volume and total value of all FLEX Option

²² See Notice, 79 FR at 19164.

²³ Id.

²⁴ See email dated June 19, 2014 from Glenn H. Gsell, Managing Director, Intercontinental Exchange, NYSE Regulation, Inc. to Michael Bradley and David Michehl, Special Counsels, Division of Trading and Markets, Commission.

trades. Thus, it appears that the Pilot Program has not caused significant trading interest to migrate from the standardized options market to the FLEX Options market, nor caused, to the best of our knowledge, a large number of investors to use FLEX Options to avoid certain requirements in the standardized market. Based on the current data and size of the FLEX Options market, and the lack of any evidence to the contrary, it would appear that investors are using the FLEX Options market for its intended purpose – to be able to customize certain terms not available in the standardized options market.

The Commission also believes that a logical corollary to making the Pilot Program permanent is to eliminate the minimum value size requirements set forth in Rules 903G(a)(4)(iii)-(iv) for transactions in currently-opened FLEX Options series and FLEX Quotes responsive to a request for quotes. In this regard, the Commission notes that the Exchange does not believe that the difference between effecting a transaction in an existing FLEX Option series and effecting a FLEX transaction in a new series is material to the extent that there should be different minimum value sizes for the two types of transactions.²⁵ In addition, the Exchange believes it would be consistent to apply the same minimum value size to closing transactions so that investors may elect to close just a portion of their FLEX position, without being subject to a minimum value size that may be greater than the equivalent value size necessary to meet their investment objectives.²⁶ Further, the Exchange believes that it would be consistent to apply the same minimum value size to FLEX Quotes so that market participants may respond to a request for quotes with the precise number of contracts or underlying equivalent value needed to trade

²⁵ See Notice, 79 FR at 19164.

²⁶ Id. Currently, the minimum value size for closing transactions is 25 contracts in the case of FLEX Equity Options and \$1 million Underlying Equivalent Value in the case of FLEX Index Options, or in either case the remaining underlying size or Underlying Equivalent Value on a closing transaction, whichever is less. See Rules 903G(a)(4)(iii)-(iv).

with the OTP Holder that submitted the request. The Commission finds no basis under the Act at this time for maintaining a minimum value size requirement for transactions in currently-opened FLEX Option series or FLEX Quotes responsive to a request for quotes, and believes that these changes should be approved for reasons similar to those supporting permanent approval of the Pilot Program. The Commission notes that it is not aware of any problems resulting from the permanent approval of CBOE's pilot eliminating FLEX Option minimum value sizes, which included currently-opened series and FLEX Quotes responsive to a request for quotes. As a result, the Commission believes that it is appropriate under the Act, and would promote just and equitable principles of trade, as well as remove impediments to and perfect the mechanism of a free and open market and a national market system, to replace the current minimum value size requirements for all FLEX Option transactions and FLEX Quotes on the Exchange with a one-contract minimum size.

Existing safeguards – such as position reporting requirements and margin requirements – will continue to apply to FLEX Options.²⁷ Further, as noted above, under Rule 9b-1 under the Act,²⁸ all customers of a broker-dealer with options accounts approved to trade FLEX Options must receive the ODD, which contains specific disclosures about the characteristics and special risks of trading FLEX Options.²⁹ In addition, similar to other options, FLEX Options are subject to Trading Permit Holder supervision and suitability requirements, such as in Rules 922 and 923,

²⁷ Certain position limit, aggregation and exercise limit requirements continue to apply to FLEX Options in accordance with Rule 906G (Position Limits) and Rule 907G (Exercise Limits). But the Commission notes that certain FLEX Options do not have position or exercise limits.

²⁸ 17 CFR 240.9b-1.

²⁹ See supra notes 13 and 16.

respectively.³⁰ In addition to ensuring that FLEX Options are suitable for their customers, broker-dealers also must take into account the characteristics of the FLEX market, as compared to the standardized market, when satisfying their best execution obligations. The Commission believes that the safeguards in place are reasonably designed to help mitigate potential risks for retail investors and other market participants investing in FLEX Options.

The Exchange believes that permanently removing the minimum value size requirements for FLEX Options will give investors a more viable, exchange-traded alternative to customized options in the OTC market, which are not subject to minimum value size requirements.³¹ Furthermore, the Exchange has represented that broker-dealers have indicated to the Exchange that the minimum value size requirements have prevented them from bringing transactions on the Exchange that are already taking place in the OTC market.³² Therefore, it appears possible that eliminating the minimum value sizes for all FLEX Options transactions and FLEX Quotes could further incent trading interest in customized options to move from the OTC market to the Exchange. To the extent investors choose to trade FLEX Options on the Exchange in lieu of the OTC market as a result of the permanent removal of the minimum value size requirements, such action should benefit investors. As the Commission has previously noted, there are certain benefits to trading on an exchange, such as enhanced efficiency in initiating and closing out positions, increased market transparency, and heightened contra-party creditworthiness due to the role of the Options Clearing Corporation as issuer and guarantor of FLEX Options.³³

IV. Solicitation of Comments on Amendment No. 1

³⁰ See Notice, 79 FR at 19163.

³¹ Id.

³² Id.

³³ See Securities Exchange Act Release No. 57429 (March 4, 2008), 73 FR 13058 (March 11, 2008) (order approving SR-CBOE-2006-36).

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 1 to 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-NYSEMKT-2014-21 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-NYSEMKT-2014-21. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; 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-NYSEMKT-2014-21 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Accelerated Approval of Proposal, as Modified by Amendment No. 1

In Amendment No. 1, the Exchange submitted a revised Pilot Report that corrects errors in the total FLEX Equity Option contract trading volume under the pilot, total FLEX Index Option contract trading volume under the pilot, and total number of FLEX Index Option trades under the pilot reported in the original Pilot Report. The revised Pilot Report also makes corresponding adjustments to other figures reported in the Pilot Report, as well non-substantive changes to certain descriptive language in the Pilot Report. The Commission believes that these corrections to the Pilot Report do not substantively alter the findings in the Pilot Report or diminish their support for approval of the pilot on a permanent basis. Accordingly, the Commission also finds good cause, pursuant to Section 19(b)(2) of the Act,³⁴ for approving the proposed rule change, as modified by Amendment No. 1, prior to the thirtieth day after the date of publication of notice in the Federal Register.

VI. Conclusion

In summary, the Commission believes, for the reasons noted above, that the proposed rule change to permanently approve the Pilot Program as well as remove the minimum size requirements for currently-opened FLEX Option series and FLEX Quotes, thereby permanently removing the minimum size requirements for all FLEX Options on the Exchange, is consistent with the Act and Section 6(b)(5) thereunder in particular, and should be approved, as amended.

³⁴ 15 U.S.C. 78s(b)(2).

The Exchange has committed, and the Commission expects the Exchange, to continue to monitor the usage of FLEX Options, whether changes need to be made to its rules or the ODD to address any changes in retail FLEX Option participation, and for any other issues that may occur as a result of the elimination of the minimum value sizes on a permanent basis, including whether FLEX Option trades are being used as a surrogate for trading options in the standardized market.³⁵

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,³⁶ that the proposed rule change (SR-NYSEMKT-2014-21) be, and it hereby is, approved, on an accelerated basis, as amended.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁷

Jill M. Peterson
Assistant Secretary

³⁵ See Notice, 79 FR at 19164 (Exchange representing that it will continue to monitor the usage of FLEX Options and whether any changes to its rules or the ODD are necessary).

³⁶ 15 U.S.C. 78s(b)(2).

³⁷ 17 CFR 200.30-3(a)(12).