

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-97898; File No. SR-FINRA-2023-010)

July 13, 2023

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Provide Relief Relating to Specified Option Transactions under FINRA Rule 4210 (Margin Requirements)

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 June 30, 2023, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. 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

FINRA is proposing to amend FINRA Rule 4210 (Margin Requirements) to provide margin relief for specified index option transactions, known as “protected options,” and to make other minor conforming revisions with regard to the margin relief.

The text of the proposed rule change is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA and at the Commission’s Public Reference Room.

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

<sup>2</sup> 17 CFR 240.19b-4.

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

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

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

1. Purpose

Cboe Exchange, Inc. (“Cboe” or the “Exchange”) filed with the SEC a proposed rule change to amend Cboe Rule 10.3 regarding margin requirements related to cash-settled index options written against exchange-traded funds (“ETF(s)”) that track the same index underlying the option.<sup>3</sup> The SEC has approved Cboe’s proposed rule change.<sup>4</sup> Cboe Rule 10.3 sets forth margin requirements, and certain exceptions to those requirements, that apply to the customers of Trading Permit Holders (“TPHs”).<sup>5</sup> Cboe stated that, under paragraph (c)(5) of Rule 10.3, TPHs generally are required to obtain

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<sup>3</sup> See Securities Exchange Act Release No. 96395 (November 28, 2022), 87 FR 74199 (December 2, 2022) (Notice of Filing of a Proposed Rule Change to Amend Rule 10.3 Regarding Margin Requirements; File No. SR-CBOE-2022-058) (“Cboe Proposal”).

<sup>4</sup> See Securities Exchange Act Release No. 97019 (March 2, 2023), 88 FR 14416 (March 8, 2023) (Order Approving a Proposed Rule Change to Amend Rule 10.3 Regarding Margin Requirements; File No. SR-CBOE-2022-058) (“Cboe Approval Order”).

<sup>5</sup> Under Cboe rules, a TPH is a holder of a license to access the facilities of the Exchange for the purpose of effecting transactions in securities traded on the Exchange without the services of another person acting as broker.

from a customer, and maintain, a margin deposit for short cash-settled index options in an amount equal to 100% of the current market value of the option plus 15% (if overlying a broad-based index) or 20% (if overlying a narrow-based index) of the amount equal to the index value multiplied by the index multiplier minus the amount, if any, by which the option is out-of-the-money.<sup>6</sup> Cboe stated the minimum margin required for such an option is 100% of the option current market value plus 10% of the index value multiplied by the index multiplier for a call or 10% of the exercise price multiplied by the index multiplier for a put.

The Cboe rule change establishes a new exception to these requirements that Cboe stated is tailored to a “protected option” strategy, as set forth in new paragraph (c)(5)(C)(iv)(e) under Cboe Rule 10.3.<sup>7</sup> Subject to specified conditions, the exception is applicable to short option positions or warrants on indexes that are offset by positions in an underlying stock basket, non-leveraged index mutual fund, or non-leveraged ETF that is based on the same index option.<sup>8</sup> Cboe stated it believes that the rule change will help reduce operational costs for customers that use the protected option strategy, while at the

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<sup>6</sup> Cboe noted that the out-of-the-money amount for a call is any excess of the aggregate exercise price of the option or warrant over the product of the current (spot or cash) index value and the applicable multiplier. The out-of-the-money amount for a put is any excess of the product of the current (spot or cash) index value and the applicable multiplier over the aggregate exercise price of the option or warrant. See Cboe Proposal, 87 FR 74199, 74201 n.8.

<sup>7</sup> See Cboe Proposal, 87 FR 74199, 74200.

<sup>8</sup> Cboe distinguishes the “protected option” strategy from a “covered call,” which is a strategy of writing an option against a position in an underlying security and is addressed by separate margin requirements under Cboe rules. See Cboe Proposal, 87 FR 74199, 74201.

same time providing an effective safeguard against the risk of a short option position.<sup>9</sup> Similarly, in approving Cboe’s rule change, the SEC stated it believes the rule change will facilitate the use of protected options and reduce associated costs and burdens.<sup>10</sup> In the interest of regulatory harmony and ensuring that the potential benefits of protected option treatment are available to FINRA members and their customers, FINRA is proposing to conform FINRA’s margin rule to the new provisions adopted by Cboe and to make other minor conforming revisions.

Specifically, FINRA proposes to establish under Rule 4210 new paragraph (f)(2)(H)(v)f. (“Protected Options”).<sup>11</sup> The new paragraph would provide that when an index call (put) option or warrant is carried “short” (the “protected option or warrant position”) and there is carried in the same account a long (short) position in an underlying stock basket, non-leveraged index mutual fund or non-leveraged ETF (each, referred to as the “protection”) that is based on the same index underlying the index option or warrant, the protected option or warrant position is not subject to the requirements set forth in paragraphs (f)(2)(E)(i) and (f)(2)(E)(iii) of Rule 4210<sup>12</sup> if the following conditions,

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<sup>9</sup> See Cboe Proposal, 87 FR 74199, 74203.

<sup>10</sup> See Cboe Approval Order, 88 FR 14416, 14418.

<sup>11</sup> See Exhibit 5.

<sup>12</sup> The exception from the margin requirements under Cboe’s new rule is as to the margin requirements set forth in Cboe Rule 10.3(c)(5)(A), which sets forth margin requirements for listed options. Paragraph (f)(2)(E)(i) under FINRA Rule 4210 correspondingly addresses listed options and is virtually identical to the Cboe provisions. Paragraph (f)(2)(E)(iii) under Rule 4210 addresses margin requirements for over-the-counter (“OTC”) products. As such, FINRA is proposing to include both listed and OTC products within the scope of the exception. Both types of products would be subject to the conditions specified under the rule which, again, are virtually identical to Cboe’s provisions. FINRA believes this harmonized approach to both listed and OTC options is appropriate

which conform to the Cboe rule, are met:

1. when the protected option or warrant position is created, the absolute value of the protection is not less than 100 percent of the aggregate current underlying index value associated with the protected option or warrant position determined at either:
  - A. the time the order that created the protected option or warrant position was entered or executed; or
  - B. the close of business on the trading day the protected option or warrant position was created;
2. the absolute value of the protection is at no time less than 95 percent of the aggregate current underlying index value associated with the protected option or warrant position; and
3. margin is maintained in an amount equal to the greater of:
  - A. the amount, if any, by which the aggregate current underlying index value is above (below) the aggregate exercise price of the protected call (put) option or warrant position; or
  - B. the amount, if any, by which the absolute value of the protection is below 100 percent of the aggregate current underlying index value associated with the protected option or warrant.

In proposing the margin exception for protected options, Cboe noted that the

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for purposes of the rule change so as to broaden availability of the benefits of the protected option strategy to, for example, non-Cboe FINRA members. This would thereby prevent a potential gap between listed and OTC options.

exception is not intended to and does not apply to leveraged instruments.<sup>13</sup>

In addition, FINRA is proposing minor revisions to paragraphs (f)(2)(H)(v)a. through d. under Rule 4210 to conform with the usage of the term “in the same account” as used in proposed paragraph (f)(2)(H)(v)f. Specifically:

- in paragraph (f)(2)(H)(v)a., the phrase “in an account in which there is also carried . . .” would be changed to read “in the same account as . . .”
- in paragraphs (f)(2)(H)(v)b. through d., the phrase “is also carried with . . .” would be changed to read “there is carried in the same account . . .”

FINRA believes these changes are appropriate because they clarify the rule text and conform with the new proposed protected option provisions.

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice. The effective date will be no later than 30 days following publication of the Regulatory Notice announcing Commission approval of the proposed rule change.<sup>14</sup>

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>15</sup> which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote

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<sup>13</sup> See Cboe Proposal, 87 FR 74199, 74201; see also Cboe Approval Order, 88 FR 14416, 14417.

<sup>14</sup> FINRA notes that the proposed rule change would not impact funding portal members and would not impact members that have elected to be treated as capital acquisition brokers (“CABs”). These members are not subject to Rule 4210.

<sup>15</sup> 15 U.S.C. 78o-3(b)(6).

just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that, by conforming FINRA Rule 4210 with Cboe's new provisions relating to protected options, the proposed rule change would promote regulatory clarity and harmonization with respect to use by customers of the protected option strategy. This would help facilitate the use of protected options and reduce associated costs and burdens while providing effective safeguards, thereby conducting to the protection of investors and the public interest. Further, for the reasons set forth in the Cboe Approval Order, the Commission found that the Cboe rule change is consistent with the provisions of Section 6(b)(5)<sup>16</sup> and Section 6(c)(3)<sup>17</sup> of the Act. Because the proposed rule change conforms with Cboe's protected options amendments, FINRA believes the proposed rule change is consistent with the corresponding provisions under Section 15A(b)(6)<sup>18</sup> and Section 15A(g)(3)<sup>19</sup> of the Act.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the

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<sup>16</sup> 15 U.S.C. 78f(b)(5). Section 6(b)(5) requires that the rules of an exchange be designed, among other things, 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, and not be designed to permit unfair discrimination between customers, issuers, brokers or dealers.

<sup>17</sup> 15 U.S.C. 78f(c)(3). Section 6(c)(3) authorizes, among other things, a national securities exchange to prescribe standards of financial responsibility or operational capability.

<sup>18</sup> 15 U.S.C. 78o-3(b)(6).

<sup>19</sup> 15 U.S.C. 78o-3(g)(3).

Act.

FINRA believes that conforming FINRA Rule 4210 with Cboe's protected option provisions would benefit FINRA members and their customers. The proposed rule change provides an additional options strategy to investors, allowing them to adopt certain options positions at potentially lower cost than is possible under the current margin requirement. The required protection that is the alternative to the margin requirement incorporates reasonable safeguards against the risks of short open positions, as proposed by Cboe and approved by the Commission. The proposed rule change would also promote competition between FINRA members and any members of Cboe (or any other exchange that adopts the Cboe rule) that are not FINRA members, by allowing FINRA members to use the protected option strategy instead of posting margin.

The proposed rule change would also expand the protected options treatment to unlisted, OTC options, so they are subject to the same conditions as for listed options. FINRA believes that harmonizing the FINRA margin requirements for OTC options with the amended Cboe rule would reduce potential regulatory arbitrage that would favor listing options on Cboe. While FINRA does not have sufficient information on how many investors or members would choose to make use of the protected options treatment for either listed or unlisted options, it believes the number is small and would be limited to institutional investors.

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

Written comments were neither solicited nor received.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be 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-FINRA-2023-010 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-FINRA-2023-010. 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 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 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. Do not include personal identifiable information in submissions; you should submit only information that you wish to make available publicly. We may redact in part or withhold entirely from publication submitted material that is obscene or subject to copyright protection. All submissions should refer to File Number SR-FINRA-2023-010 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.<sup>20</sup>

**J. Matthew DeLesDernier,**

*Deputy Secretary.*

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<sup>20</sup> 17 CFR 200.30-3(a)(12).