

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-82005; File No. SR-PHLX-2017-055)

November 2, 2017

Self-Regulatory Organizations; NASDAQ PHLX LLC; Order Approving Proposed Rule Changes to Amend Rules 1024, Conduct of Accounts for Options Trading, and 1025, Supervision of Accounts

**I. Introduction**

On September 7, 2017, NASDAQ PHLX LLC (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> proposed rule changes to amend Phlx Rules 1024 (Conduct of Accounts for Options Trading) and 1025 (Supervision of Accounts) to conform them more closely to the comparable rules of the Chicago Board Options Exchange (“CBOE”) and to make minor clarifications and corrections to the text.

The proposed rule changes were published for comment in the Federal Register on September 22, 2017.<sup>3</sup> The public comment period closed on October 13, 2017. The Commission received no comments on the proposed rule changes. This order approves the proposed rule changes.

**II. Description of the Proposed Rule Changes<sup>4</sup>**

Rules 1024 and 1025 contain regulatory requirements generally applicable to Phlx members and member organizations that conduct a public customer options business. The

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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 Exchange Act Release No. 81642 (Sept. 18, 2017), 82 FR 44481 (Sept. 22, 2017) (“Notice”).

<sup>4</sup> The subsequent description of the proposed rule changes is substantially excerpted from the Exchange’s description in the Notice. See Notice, 82 FR 44481-83.

Exchange is proposing changes to certain sections of those rules to clarify the language and to correct inaccuracies. The Exchange also proposes to change certain rule language to conform the rules more closely to CBOE rules dealing with the same subject matter, in order to prevent inadvertent misunderstandings of the rules' requirements. These rule changes are intended to promote more effective regulatory compliance by Exchange members and member organizations. The proposed changes are detailed below.

*Rule 1024(a)(i)*

Rule 1024(a)(i) governs registration of Options Principals.<sup>5</sup> The rule currently provides that no member or member organization or individual associated with a member organization shall be approved to transact options business with the public until such persons, who are designated as Options Principals, have been approved by and registered with the Exchange. Additionally, it provides that persons engaged in the supervision of options sales practice or a person to whom the designated general partner or executive officer (pursuant to Rule 1025) or another Registered Options Principal<sup>6</sup> delegates the authority to supervise options sales practices shall be designated as Options Principals. Finally, the rule states that all members and member organizations must use Web CRD to submit Form U4, Uniform Application for Securities Industry Registration or Transfer filings on behalf of their Options Principals. Members and member organizations are required under the rule to amend Form U4 filings not later than thirty (30) days after the filer knew or should have known of the facts which gave rise to the amendment.

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<sup>5</sup> See Rule 612(d).

<sup>6</sup> Id.

The Exchange is proposing to amend Rule 1024(a)(i) by adopting language requiring Options Principals to electronically file a Uniform Application for Securities Industry Registration or Transfer (Form U4) with Web CRD, to successfully complete an examination prescribed by the Exchange and specified in Rule 1024 for the purpose of demonstrating an adequate knowledge of the options business and of the Rules of the Exchange, and to further agree in the U4 filing to abide by the Bylaws and Rules of the Exchange and the Rules of The Options Clearing Corporation. The Exchange is proposing to remove the sentence that requires members and member organizations to amend Form U4 filings not later than thirty (30) days after the filer knew or should have known of the facts which gave rise to the amendment. However, the Exchange proposes to add language requiring members and member organizations that are required to complete Form U4 to promptly (but in any event no later than 30 days after the filer knew or should have known of the facts which gave rise to the need for the amendment) electronically file any required amendments to Form U4 with Web CRD. Additionally, new language is proposed that would require termination of employment or affiliation of any Registered Options Principal in such capacity to be promptly, but in any event no later than 30 days following the termination, electronically reported to Web CRD together with a brief statement of the reason for such termination on Form U5. The amendment would conform Rule 1024(a) more closely to CBOE Rule 9.2. The proposal would also correct a reference in the second sentence to “options sale practice,” substituting for that term “options sales practices.”

*Rule 1024(b)(ii)*

Rule 1024(b)(ii) generally provides that, in approving a customer's account for options transactions, a member or member organization shall exercise due diligence to learn the essential facts as to the customer and his investment objectives and financial situation, and shall make a

record of such information. It also provides for approval and for confirmation of approval of the customer's account by a Registered Options Principal qualified individual.

For purposes of clarity, the Exchange proposes to eliminate references in Rule 1024(b)(ii) to a "specific" or "specified" Registered Options Principal. It also proposes to delete the words "qualified individual" as they appear following references to Registered Options Principals to eliminate any ambiguity, as it is not clear what a Registered Options Principal qualified individual means if not a Registered Options Principal. Finally, the Exchange proposes to relocate the phrase "within a reasonable period of time" simply to conform the rule in this respect more closely to CBOE Rule 9.7.

*Rule 1024(c)(v)*

Rule 1024(c)(v) is proposed to be amended by changing an inaccurate internal cross reference, from Rule 1029(c) to Rule 1029(b).

*Rule 1024 Commentary .01 Section 8*

The Exchange is proposing to delete the word "other" as unnecessary and to correct the placement of a closing parenthesis, moving it from after the word "transactions" to after the word "commodities."

*Rule 1024 Commentary .03*

The Exchange is proposing to add the inadvertently omitted word "an" before the word "opportunity."

*Rule 1024 Commentary .06*

The Exchange is proposing to reword the sentence for clarity, so that it states that individuals engaged in the supervision of options sales practices are required to be designated as Options Principals and are required to qualify as an Options Principal by passing one of the

examinations referred to in the rule. The Exchange also proposes to amend the rule's reference to the Series 9/10 examination, in order to use the same name that the Financial Industry Regulatory Authority ("FINRA") uses for that examination.

*Rule 1024 Commentary .07*

The Exchange proposes to add the inadvertently dropped word "reviewing" to a sentence that requires individuals who are delegated responsibility for reviewing, among other things, the acceptance of discretionary accounts, to be designated as Options Principals and pass the Series 4 examination.

*Rule 1025(a)(iii)A*

The Exchange proposes to substitute the word "responsibility" for the word "responsibilities" simply to conform the rule more closely to CBOE Rule 9.8(a)(3)(i).

*Rule 1025(b)(i)*

The Exchange proposes to make non-substantive wording changes to conform the rule language more closely to that of CBOE Rule 9.8(b)(1) by removing the unnecessary words "above-noted," by replacing the words "requirements applicable to" with the words "responsibility of," by deleting the unnecessary words "however, the," and by replacing the words "other than the principal supervisory office if such documents and information" with the words "off premises so long as the records."

*Rule 1025(b)(iii)*

The Exchange proposes to capitalize the word "Rule" in a reference to SEC Rule 17a-4, to conform the language more closely to CBOE Rule 9.8(b)(3).

*Rule 1025(b) concluding sentence*

The words “any person” are proposed to be substituted for the words “a person”, and an inaccurate reference to “this paragraph (b)(3)” is proposed to be corrected to read “this paragraph (b)(iii).”

*Rule 1025(d)*

An extraneous word “the” is proposed to be deleted before the word “proximity” to conform more closely to CBOE Rule 9.8(d)(1)(i), and an inaccurate reference to Rule 1025(c) is proposed to be corrected to read Rule 1025(e).

*Rule 1025(e)*

The Exchange proposes to remove an extraneous comma to conform the rule more closely to CBOE Rule 9.8(e)(1) and to change an incorrect internal cross reference from paragraph (e)(1) to paragraph (e)(i).

*Rule 1025(g)*

Currently, Rule 1025(g) requires each member organization that conducts a non-member customer business to submit each year to the Exchange a written report on the member organization's supervision and compliance effort during the preceding year. The Exchange proposes to expand the requirement to conform it more closely to CBOE Rule 9.8(g), by specifying that the report must also detail the adequacy of the member organization's ongoing compliance processes and procedures. The proposed amendments to Rule 1025(g) would also require the Chief Executive Officer (or equivalent) to certify that the member organization has in place processes to test the effectiveness of policies and procedures on a periodic, rather than on a regular, basis. This change would conform the Exchange's requirement more closely to the

comparable CBOE Rule 9.8(g)5(i)(C) requirement. The proposal would also correct the spelling of the word “preceding” in Rule 1025(g)(ii), add missing semicolons to an itemized list found in Rule 1025(g)(iii), correct inaccurate internal cross references in Rules 1025(g)(v)(C) and (D), as well as correct the placement of a closing parenthesis in Rule 1025(g)(v)(C). Finally, it would replace the awkward phrase “this requirement of this Rule” with “the requirements of this Rule.”

*Rule 1025(h)*

Rule 1025(h) currently provides that each member organization shall submit the report required by Rule 1024(g) to its one or more control persons or, if the member organization has no control person, to the audit committee of its board of directors or its equivalent committee or group. The Exchange proposes to replace the inaccurate reference to Rule 1024(g) with a correct reference to Rule 1025(g). The Exchange proposes to add language to the end of the rule to establish the meaning of “control person,” proposed to be defined as a person who controls the member organization. The new language would define the term “control” as meaning the power to exercise a controlling influence over the management or policies of the member organization, unless such power is solely the result of an official position with the member organization. Finally, the new language would state that any person who owns beneficially, directly or indirectly, more than 20% of the voting power in the election of directors of the member organization, or more than 25% of the voting power in the election of directors of any other corporation which directly or through one or more affiliates owns beneficially more than 25% of the voting power in the election of directors of the member organization, shall be presumed to control the member organization. The proposed new language is based on CBOE Rules 9.8(h) and 1.1(k), which is incorporated by reference into CBOE Rule 9.8(h).

*Rule 1025 Commentary .02 and .03*

Rule 1025 Commentary .02 is proposed to be amended by deleting the introductory phrase “In meeting their supervisory responsibilities” in order to conform the language more closely to CBOE Rule 9.8, Interpretations and Policies .01. The rule currently requires member organizations conducting a non-member customer business to enforce written procedures governing the conduct of options accounts. As revised, the written procedures would be required to detail the specific methods used to supervise all non-member customer accounts and all orders in such accounts. This amendment would also provide greater clarity regarding the required content of the procedures and also would conform the rule more closely to CBOE Rule 9.8, Interpretations and Policies .01. The last sentence of Commentary .02 would be revised by replacing the phrase “short uncovered” options positions with the phrase “uncovered short” options positions. Finally, the Exchange proposes to amend Rule 1025 Commentary .03 by adding the word “shall” to the first sentence, to conform the language more closely to CBOE Rule 9.8, Interpretations and Policies .02.

**IV. Discussion and Commission Findings**

After careful review of the proposed rule changes, the Commission finds that the proposal is consistent with the requirements of the Exchange Act and the rules and regulations thereunder that are applicable to a national securities exchange.<sup>7</sup> Specifically, the Commission finds that the proposed rule changes are consistent with Section 6(b)(5) of the Exchange Act,<sup>8</sup> which requires, among other things, that the rules of a national securities exchange be designed to prevent

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<sup>7</sup> In approving these rule changes, the Commission has considered the rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

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. Section 6(b)(5) also requires that the rules of an exchange not be designed to permit unfair discrimination among customers, issuers, brokers, or dealers.

The proposal is designed to “remove impediments to and perfect the mechanism of a free and open market and a national market system, by correcting various aspects of the rules and by adding additional clarity to the rules.”<sup>9</sup> The Commission notes that Phlx believes that conforming its rules regarding conduct of accounts for options trading and supervision of accounts more closely to the corresponding CBOE rules will create “more efficient regulatory compliance by members of both exchanges due to reduction of differences in wording and consequent potential for inadvertent regulatory noncompliance.”<sup>10</sup> The Commission further notes that Phlx believes that the minor corrections and clarifications of the rules in the proposal will “improve the accuracy of the rules” and “improve their readability, making them more understandable and thereby facilitating easier compliance.”<sup>11</sup> The Commission notes that the proposal received no comments from the public.

The Commission believes that the proposal will promote regulatory efficiency through more precise rule text and greater harmonization of regulatory requirements across national securities exchanges, thereby reducing regulatory burdens, without undermining strong regulatory protections for investors. The Commission believes that the approach proposed by the

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<sup>9</sup> See Notice, 82 FR at 44483.

<sup>10</sup> See id.

<sup>11</sup> See id.

Exchange is appropriate and designed to protect investors and the public interest, consistent with Section 6(b)(5) of the Exchange Act. For these reasons, the Commission finds that the proposed rule changes are consistent with the Exchange Act and the rules and regulations thereunder.

**V. Conclusion**

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2)<sup>12</sup> of the Exchange Act that the proposal (SR-PHLX-2017-055), be and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>13</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>12</sup> 15 U.S.C. 78s(b)(2).

<sup>13</sup> 17 CFR 200.30-3(a)(12).