SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-87822; File No. SR-Phlx-2019-54)

December 20, 2019

Self-Regulatory Organizations; Nasdaq PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Adopt a New Rule Titled "Off-Exchange RWA Transfers" at Phlx Rule 1045

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on December 17, 2019, Nasdaq PHLX LLC ("Phlx" or "Exchange") 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 the Exchange. 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

The Exchange proposes to adopt a new rule titled "Off-Exchange RWA Transfers" at Phlx Rule 1045.

The text of the proposed rule change is available on the Exchange's Website at http://nasdaqphlx.cchwallstreet.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 Exchange 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

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

Item IV below. The Exchange 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

The Exchange proposes to adopt a new rule titled, "Off-Exchange RWA Transfers" at Phlx Rule 1045, which is currently reserved. This proposal is substantially the same as Cboe Exchange, Inc. ("Cboe") Rule 6.8.[3]

Proposed Rule 1045 is intended to facilitate the reduction of risk-weighted assets ("RWA") attributable to open options positions. SEC Rule 15c3-1 (Net Capital Requirements for Brokers or Dealers) ("Net Capital Rules") requires registered broker-dealers, unless otherwise excepted, to maintain certain specified minimum levels of capital.[4] The Net Capital Rules are designed to protect securities customers, counterparties, and creditors by requiring that broker-dealers have sufficient liquid resources on hand, at all times, to meet their financial obligations. Notably, hedged positions, including offsetting futures and options contract positions, result in certain net capital requirement reductions under the Net Capital Rules.[5]

Subject to certain exceptions, Clearing Members[6] are subject to the Net Capital Rules.[7] However, a subset of Clearing Members are subsidiaries of U.S. bank holding companies, which,

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3 See Securities Exchange Act Release No. 87374 (October 21, 2019), 84 FR 57542 (October 25, 2019) (SR-Cboe-2019-044).

4 17 CFR §240.15c3-1.

5 In addition, the Net Capital Rules permit various offsets under which a percentage of an option position's gain at any one valuation point is allowed to offset another position's loss at the same valuation point (e.g. vertical spreads).

6 The term Clearing Member is defined within Rule 1000(b)(3). All Clearing Members must also be clearing members of The Options Clearing Corporation ("Clearing Corporation" or "OCC").

due to their affiliations with their parent U.S.-bank holding companies, must comply with additional bank regulatory capital requirements pursuant to rulemaking required under the Dodd-Frank Wall Street Reform and Consumer Protection Act.[8] Pursuant to this mandate, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation have approved a regulatory capital framework for subsidiaries of U.S. bank holding company clearing firms.[9] Generally, these rules, among other things, impose higher minimum capital and higher asset risk weights than were previously mandated for Clearing Members that are subsidiaries of U.S. bank holding companies under the Net Capital Rules. Furthermore, the new rules do not fully permit deductions for hedged securities or offsetting options positions.[10] Rather, capital charges under these standards are, in large part, based on the aggregate notional value of short positions regardless of offsets. As a result, in general, Clearing Members that are subsidiaries of U.S. bank holding companies must hold substantially more bank regulatory capital than would otherwise be required under the Net Capital Rules.

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7 In the event federal regulators modify bank capital requirements in the future, the Exchange will reevaluate the proposed rule change at that time to determine whether any corresponding changes to the proposed rule are appropriate.

8 H.R. 4173 (amending section 3(a) of the Securities Exchange Act of 1934 (the "Act") (15 U.S.C. § 78c(a))).

9 12 CFR §50; 79 FR 61440 (Liquidity Coverage Ratio: Liquidity Risk Measurement Standards).

10 Many options strategies, including relatively simple strategies often used by retail customers and more sophisticated strategies used by broker-dealers, are risk limited strategies or options spread strategies that employ offsets or hedges to achieve certain investment outcomes. Such strategies typically involve the purchase and sale of multiple options (and may be coupled with purchases or sales of the underlying securities), executed simultaneously as part of the same strategy. In many cases, the potential market exposure of these strategies is limited and defined.

The Exchange is concerned with the ability of Registered Options Traders[11] and Specialists[12] (collectively "Market Makers") to provide liquidity in their appointed classes. The Exchange believes that permitting market participants to efficiently transfer existing options positions through an off-exchange transfer process would likely have a beneficial effect on continued liquidity in the options market without adversely affecting market quality. Liquidity in the listed options market is critically important. The Exchange believes that the proposed rule change provides market participants with an efficient mechanism to transfer their open options positions from one clearing account to another clearing account and thereby increase liquidity in the listed options market. Phlx currently has no mechanism that firms may use to transfer positions between clearing accounts without having to effect a transaction with another party and close a position.

The proposed rule provides that existing positions in options listed on the Exchange of a Member or non-Member (including an affiliate of a Member) may be transferred on, from, or to the books of a Clearing Member off the Exchange if the transfer establishes a net reduction of RWA attributable to those options positions (an "RWA Transfer"). Proposed paragraph (a)(1) adds examples of two transfers that would be deemed to establish a net reduction of RWA, and thus qualify as a permissible RWA Transfer:

- A transfer of options positions from Clearing Corporation member A to Clearing Corporation member B that net (offset) with positions held at Clearing Corporation

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11 See Rule 1000(b)(57). A "Registered Options Trader" shall mean a Streaming Quote Trader or a Remote Streaming Quote Trader who enters quotations for his own account electronically into the System.

12 See Rule 1000(b)(58). A "Specialist" shall mean a member who is registered as an options Specialist pursuant to Rule 1020(a). A Specialist includes a Remote Specialist which is defined as a Specialist in one or more classes that does not have a physical presence on an Exchange's trading floor and is approved by the Exchange pursuant to Rule 501.

member B, and thus closes all or part of those positions (as demonstrated in the example below)[13]; and

- A transfer of options positions from a bank-affiliated Clearing Corporation member to a non-bank-affiliated Clearing Corporation member.[14]

These transfers will not result in a change in ownership, as they must occur between accounts of the same Person.

"Person" is defined within proposed Rule 1045(a) as an individual, partnership (general or limited), joint stock company, corporation, limited liability company, trust or unincorporated organization, or any governmental entity or agency or political subdivision thereof.

In other words, RWA transfers may only occur between the same individual or legal entity. These are merely transfers from one clearing account to another, both of which are attributable to the same individual or legal entity. A market participant effecting an RWA Transfer is analogous to an individual transferring funds from a checking account to a savings account, or from an account at one bank to an account at another bank – the money still belongs to the same person, who is just holding it in a different account for personal financial reasons.

For example, Market Maker A clears transactions on the Exchange into an account it has with Clearing Member X, which is affiliated with a U.S-bank holding company. Market Maker A opens a clearing account with Clearing Member Y, which is not affiliated with a U.S.-bank holding company. Clearing Member X has informed Market Maker A that its open positions may not exceed a certain amount at the end of a calendar month, or it will be subject to

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13 This transfer would establish a net reduction of RWA attributable to the transferring Person, because there would be fewer open positions and thus fewer assets subject to Net Capital Rules.

14 This transfer would establish a net reduction of RWA attributable to the transferring Person, because the non-bank-affiliated Clearing Corporation member would not be subject to Net Capital Rules, as described above.

restrictions on new positions it may open the following month. On August 28, Market Maker A reviews the open positions in its Clearing Member X clearing account and determines it must reduce its open positions to satisfy Clearing Member X's requirements by the end of August. It determines that transferring out 1000 short calls in class ABC will sufficiently reduce the RWA capital requirements in the account with Clearing Member X to avoid additional position limits in September. Market Maker A wants to retain the positions in accordance with its risk profile. Pursuant to the proposed rule change, on August 31, Market Maker A transfers 1000 short calls in class ABC to its clearing account with Clearing Member Y. As a result, Market Maker A can continue to provide the same level of liquidity in class ABC during September as it did in previous months.

A Member must give up a Clearing Member for each transaction it effects on the Exchange, which identifies the Clearing Member through which the transaction will clear.[15] A Member may change the give up for a transaction within a specified period of time.[16] Additionally, a Member may also change the Clearing Member[17] for a specific transaction. The transfer of positions from an account with one clearing firm to the account of another clearing firm pursuant to the proposed rule change has a similar result as changing a give up or CMTA, as it results in a position that resulted from a transaction moving from the account of one clearing firm to another, just at a different time and in a different manner.[18] In the above example, if Market Maker A had

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15 See Phlx Rule 1043.

16 See Phlx Rule 1037.

17 The Clearing Member Trade Assignment ("CMTA") process at OCC facilitates the transfer of option trades/positions from one OCC clearing member to another in an automated fashion. Changing a CMTA for a specific transaction would allocate the trade to a different OCC clearing member than the one initially identified on the trade.

18 The transferred positions will continue to be subject to OCC rules, as they will continue to be held in an account of an OCC member.

initially given up Clearing Member Y rather than Clearing Member X on the transactions that resulted in the 1000 long calls in class ABC, or had changed the give-up or CMTA to Clearing Member Y pursuant to Rule 1045 the ultimate result would have been the same. There are a variety of reasons why firms give up or CMTA transactions to certain clearing firms (and not to non-bank affiliate clearing firms) at the time of a transaction, and the proposed rule change provides firms with a mechanism to achieve the same result at a later time.

Proposed paragraph (a)(2) states RWA Transfers may occur on a routine, recurring basis. As noted in the example above, clearing firms may impose restrictions on the amount of open positions. Permitting transfers on a routine, recurring basis will provide market participants with the flexibility to comply with these restrictions when necessary to avoid position limits on future options activity. Additionally, proposed paragraph (a)(6) provides that no prior written notice to the Exchange is required for RWA Transfers. Because of the potential routine basis on which RWA Transfers may occur, and because of the need for flexibility to comply with the restrictions described above, the Exchange believes it may interfere with the ability of investors firms to comply with any Clearing Member restrictions describe above, and may be burdensome to provide notice for these routine transfers.

Proposed paragraph (a)(3) states RWA Transfers may result in the netting of positions. Netting occurs when long positions and short positions in the same series "offset" against each other, leaving no or a reduced position. For example, if there were 100 long calls in one account, and 100 short calls of the same option series were added to that account, the positions would offset, leaving no open positions. Currently, the Exchange permits off-exchange transfers on behalf of a Market Maker account for transactions in multiply listed options series on different exchanges, but only if the Market Maker nominees are trading for the same Member, and the

options transactions on the different options exchanges clear into separate exchange-specific accounts because they cannot easily clear into the same Market Maker account at OCC. In such instances, all Market Maker positions in the exchange-specific accounts for the multiply listed class would be automatically transferred on their trade date into one central Market Maker account (commonly referred to as a "universal account") at the Clearing Corporation. Positions cleared into a universal account would automatically net against each other.

While RWA Transfers are not occurring because of limitations related to trading on different exchanges, similar reasoning for the above exception applies to why netting should be permissible for the limited purpose of reducing RWA. Firms may maintain different clearing accounts for a variety of reasons, such as the structure of their businesses, the manner in which they trade, their risk management procedures, and for capital purposes. If a Market Maker clears all transactions into a universal account, offsetting positions would automatically net. However, if a Market Maker has multiple accounts into which its transactions cleared, they would not automatically net. While there are times when a firm may not want to close out open positions to reduce RWA, there are other times when a firm may determine it is appropriate to close out positions to accomplish a reduction in RWA.

In the example above, suppose after making the RWA Transfer described above, Market Maker A effects a transaction on September 25 that results in 1000 long calls in class ABC, which clears into its account with Clearing Member X. If Market Maker A had not effected its RWA Transfer in August, the 1000 long calls would have offset against the 1000 short calls, eliminating both positions and thus any RWA capital requirements associated with them. At the end of August, Market Maker A did not want to close out the 1000 short calls when it made its RWA Transfer. However, given changed circumstances in September, Market Maker A has

determined it no longer wants to hold those positions. The proposed rule change would permit Market Maker A to effect an RWA Transfer of the 1000 short calls from its account with Clearing Member Y to its account with Clearing Member X (or vice versa), which results in elimination of those positions (and a reduction in RWA associated with them). As noted above, such netting would have occurred if Market Maker A cleared the September transaction directly into its account with Clearing Member Y, or had not effected an RWA Transfer in August. Netting provides market participants with appropriate flexibility to conduct their businesses as they see fit while having the ability to reduce RWA capital requirements when necessary.

RWA Transfers may not result in preferential margin or haircut treatment.[19] Additionally, RWA Transfers may only be effected for options listed on the Exchange and will be subject to applicable laws, rules, and regulations, including rules of other self-regulatory organizations (including OCC).[20]

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,[21] in general, and furthers the objectives of Section 6(b)(5) of the Act,[22] in particular, in that it is designed 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. Additionally, the Exchange believes the proposed rule change

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19 See proposed paragraph (a)(4).

20 See proposed introductory paragraph and proposed paragraph (a)(7). Transfers of non-Exchange listed options and other financial instruments are not governed by this proposed rule. Any RWA transfers will be subject to all applicable recordkeeping requirements applicable to Members and Clearing Members under the Securities Exchange Act of 1934, and the rules and regulations thereunder (the "Act"), such as Rule 17a-3 and 17a-4.

21 15 U.S.C. 78f(b).

22 15 U.S.C. 78f(b)(5).

is consistent with the Section 6(b)(5)[23] requirement that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers. The Exchange's proposal is substantially the same as Cboe Rule 6.8 [sic]

In particular, the Exchange believes the proposed rule change to permit RWA Transfers will remove impediments to and perfect the mechanism of a free and open market and a national market system by providing liquidity in the listed options market. The Exchange believes providing market participants with an efficient process to reduce RWA capital requirements attributable to open positions in clearing accounts with U.S. bank-affiliated clearing firms may contribute to additional liquidity in the listed options market, which, in general, protects investors and the public interest.

The proposed rule change, in particular the proposed changes to permit RWA transfers to occur on a routine, recurring basis and result in netting, also provides market participants with sufficient flexibility to reduce RWA capital requirements at times necessary to comply with requirements imposed on them by clearing firms. This will permit market participants to respond to then-current market conditions, including volatility and increased volume, by reducing the RWA capital requirements associated with any new positions they may open while those conditions exist. Given the additional capital that may become available to market participants as a result of the RWA Transfers, market participants will be able to continue to provide liquidity to the market, even during periods of increased volume and volatility, which liquidity ultimately benefits investors. It is not possible for market participants to predict what market conditions will exist at a specific time, and when volatility will occur. The proposed rule change to permit routine, recurring RWA Transfers (and to not provide prior written notice) will

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23 Id.

provide market participants with the ability to respond to these conditions whenever they occur. Permitting transfers on a routine, recurring basis will provide market participants with the flexibility to comply with these restrictions when necessary to avoid position limits on future options activity. In addition, with respect to netting, as discussed above, firms may maintain different clearing accounts for a variety of reasons, such as the structure of their businesses, the manner in which they trade, their risk management procedures, and for capital purposes. Netting may otherwise occur with respect to a firm's positions if it structured its clearing accounts differently, such as by using a universal account. Therefore, the proposed rule change will permit netting while allowing firms to continue to maintain different clearing accounts in a manner consistent with their businesses.

The Exchange recognizes the numerous benefits of executing options transactions occur on an exchanges, including price transparency, potential price improvement, and a clearing guarantee. However, the Exchange believes it is appropriate to permit RWA Transfers to occur off the exchange, as these benefits are inapplicable to RWA Transfers. RWA Transfers have a narrow scope and are intended to achieve a limited, benefit purpose. RWA Transfers are not intended to be a competitive trading tool. There is no need for price discovery or improvement, as the purpose of the transfer is to reduce RWA asset capital requirements attributable to a market participants' positions. Unlike trades on an exchange, the price at which an RWA Transfers occurs is immaterial – the resulting reduction in RWA is the critical part of the transfer. RWA Transfers will result in no change in ownership, and thus they do not constitute trades with a counterparty (and thus eliminating the need for a counterparty guarantee). The transactions that resulted in the open positions to be transferred as an RWA Transfer were already guaranteed by an OCC clearing member, and the positions will continue to be subject to

OCC rules, as they will continue to be held in an account with an OCC clearing member. The narrow scope of the proposed rule change and the limited, beneficial purpose of RWA Transfers make allowing RWA Transfers to occur off the floor appropriate and important to support the provision of liquidity in the listed options market.

The proposed rule change does not unfairly discriminate against market participants, as all Members and non-Members with open positions in options listed on the Exchange may use the proposed off-exchange transfer process to reduce the RWA capital requirements of Clearing Members.

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 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. This process is not intended to be a competitive trading tool. The Exchange does not believe that the proposed rule change will impose any burden on intra-market competition that is not necessary or appropriate in furtherance of the purposes of the Act, as use of the proposed process is voluntary. All Members and non-Members with open positions in options listed on the Exchange may use the proposed off-exchange transfer process to reduce the RWA capital requirements attributable to those positions. The Exchange does not believe that the proposed rule change will impose any burden on intermarket competition that is not necessary or appropriate in furtherance of the purposes of the Act. RWA Transfers have a limited purpose, which is to reduce RWA attributable to open positions in listed options in order to free up capital. The Exchange believes the proposed rule change may relieve the burden on liquidity providers in the options market by reducing the RWA attributable to their open positions. As a

result, market participants may be able to increase liquidity they provide to the market, which liquidity benefits all market participants.

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

No written comments were either solicited or received.

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A)(iii) of the Act[24] and subparagraph (f)(6) of Rule 19b-4 thereunder.[25]

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

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24 15 U.S.C. 78s(b)(3)(A)(iii).

25 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-Phlx-2019-54 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-Phlx-2019-54. 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.

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-Phlx-2019-54 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[26]

J. Matthew DeLesDernier
Assistant Secretary

[26] 17 CFR 200.30-3(a)(12).