

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-99696; File No. SR-FINRA-2023-010)

March 8, 2024

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

I. Introduction

On June 30, 2023, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities and Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change 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 proposed rule change was published for comment in the Federal Register on July 19, 2023.³ On August 31, 2023, FINRA extended the time period in which the Commission must approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change to October 17, 2023.⁴ On September 28, 2023, the Commission published an order instituting proceedings to determine whether to approve or disapprove the proposed rule change.⁵ On January 9, 2024, the Commission designated a longer

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Exchange Act Release No. 97898 (July 13, 2023), 88 FR 46204 (“Notice”).

⁴ See Letter from Adam Arkel, Associate General Counsel, FINRA, to Sheila Swartz, Division of Trading and Markets, Commission (Aug. 31, 2023).

⁵ See Exchange Act Release No. 98628 (Sept. 28, 2023), 88 FR 68855 (Oct. 4, 2023).

period for Commission action on the proposed rule change.⁶ The Commission received comment letters on the proposed rule change.⁷ This order approves the proposed rule change.

II. Description of the Proposed Rule Change

In its filing with the Commission, FINRA stated that Cboe Exchange, Inc. (“Cboe” or the “Exchange”) filed with the Commission 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,⁸ which the Commission approved on March 2, 2023.⁹

FINRA stated that the Cboe rule change established a new exception to those margin requirements with respect to a “protected option” strategy, as set forth in new paragraph (c)(5)(C)(iv)(e) under Cboe Rule 10.3.¹⁰ 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-

⁶ See Exchange Act Release No. 99304, 89 FR 2659 (Jan. 16, 2024). The Commission designated March 15, 2024, as the date by which the Commission shall approve or disapprove the proposed rule change.

⁷ All comments received on the proposed rule change are available at <https://www.sec.gov/comments/sr-finra-2023-010/srfinra2023010.htm>.

⁸ See Exchange Act Release No. 96395 (Nov. 28, 2022), 87 FR 74199 (Dec. 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”). See also Notice at 46205, n.3.

⁹ See Exchange Act Release No. 97019 (Mar. 2, 2023), 88 FR 14416 (Mar. 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”).

¹⁰ See Notice at 46205.

leveraged ETF that is based on the same index option.¹¹ In approving Cboe’s rule change, FINRA observed that the Commission stated it believes the rule change will facilitate the use of protected options and reduce associated costs and burdens.¹² FINRA stated that, 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 proposed to conform its margin rule to the provisions Cboe adopted and to make other minor conforming revisions.¹³

Specifically, FINRA proposed to establish under FINRA Rule 4210 new paragraph (f)(2)(H)(v)f. (“Protected Options”).¹⁴ 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 4210¹⁵ if the following conditions,

¹¹ 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 at 74201. See also Notice at 46205, n.8.

¹² See Cboe Approval Order at 14418.

¹³ See Notice at 46205.

¹⁴ See Exhibit 5 to the proposed rule change, available at <https://www.sec.gov/files/rules/sro/finra/2023/34-97898-ex5.pdf>.

¹⁵ FINRA stated that 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. According to FINRA, 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 FINRA Rule 4210 addresses margin requirements for over-the-counter (“OTC”) products. As such, FINRA

which conform to the Cboe rule, are met:¹⁶

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.¹⁷

proposed to include both listed and OTC products within the scope of the exception. FINRA stated that both types of products would be subject to the conditions specified under the rule which, according to FINRA, are virtually identical to Cboe's provisions. FINRA stated that it believes this harmonized approach to both listed and OTC options is appropriate for purposes of the rule change to broaden availability of the benefits of the protected option strategy to, for example, non-Cboe FINRA members, and would thereby prevent a potential gap between listed and OTC options. See also Notice at 46205, n.12.

¹⁶ See id. at 46205.

¹⁷ See id.

FINRA stated that in proposing the margin exception for protected options, Cboe emphasized that the exception is not intended to and does not apply to leveraged instruments.¹⁸

In addition, FINRA proposed minor revisions to paragraphs (f)(2)(H)(v)a. through d. under FINRA Rule 4210 to conform with the usage of the term “in the same account” as used in proposed paragraph (f)(2)(H)(v)f.¹⁹ 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 . . .”²⁰

FINRA stated that it believes these changes are appropriate because they clarify the rule text and conform with the new proposed protected option provisions.²¹

Lastly, FINRA stated that if the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice.²² The effective date will be no later than 30 days following publication of the Regulatory Notice announcing Commission approval of the proposed rule change.²³

¹⁸ See Cboe Proposal at 74201; see also Cboe Approval Order at 14417 and Notice at 46205.

¹⁹ See Notice at 46205.

²⁰ See id.

²¹ See id.

²² See id.

²³ See id. at 46205-46206. FINRA stated 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”). According to FINRA, these members are not subject to Rule 4210. See id. at 46205, n.14.

III. Commission Discussion and Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to a national securities association.²⁴ In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Exchange Act,²⁵ which requires, among other things, that the association's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to facilitate transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and, in general, to protect investors and the public interest.

²⁴ 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). See e.g., discussions below regarding how customers of broker-dealers will benefit from a reduction in transaction costs and improved operational efficiencies, as well as how the proposed rule change will reduce burdens for customers of broker-dealers by providing them a margin exception for protected options.

²⁵ 15 U.S.C. 78q-3(b)(6).

The Commission received comment letters in response to the proposal.²⁶ Cboe urged the Commission to promptly approve the proposed rule change.²⁷ Cboe stated that the Commission has already considered the policy issues the proposed rule change presents under the Cboe Proposal, which the Commission previously determined to be consistent with the Exchange Act and beneficial to investors.²⁸ Further, Cboe stated in its comment letter that prompt Commission approval of the proposed rule change will provide FINRA members with the same ability to offer margin relief for protected options that is now available under Cboe Options Rules.²⁹ Cboe stated, as a result, a significant number of industry members that accommodate protected option strategies can realize the potential operational efficiencies offered by the margin rule described in the proposed rule change (and the Cboe Proposal) and will promote regulatory harmonization regarding margin requirements.³⁰

²⁶ See supra note 7. A few commenters addressed short options or short options strategies more generally, and therefore, those comments are outside the scope of this proposal. See Letter from Nick Steinmetz, Individual Investor (July 19, 2023); Letter from Anonymous (July 20, 2023); Letter from Anonymous (Nov. 22, 2023). Some commenters addressed option strategies involving options hedging other options or cases where the writer of a short option would need to deliver shares (rather than cash) if the option is exercised. See Letter from Brian Herrmann, Individual Investor (Oct. 5, 2023); Letter from Joshua Dobos, Individual Investor (Oct. 6, 2023); Letter from Sean Shanks, Individual Investor (Oct. 6, 2023) (“Shanks Letter”). Another commenter stated that traders should not have the opportunity to offset short option positions with ETFs and stock baskets, but should be hedged with the underlying asset. See Letter from Anonymous (Oct. 6, 2023). This proposed rule change generally applies to cash-settled (*i.e.*, not settled in the underlying asset) short option positions or warrants on broad-based 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.

²⁷ See Letter from Laura G. Dickman, Vice President and Associate General Counsel, Cboe Global Markets, Inc., to Vanessa Countryman, Secretary, Commission (Aug. 4, 2023) (“Cboe Letter”).

²⁸ See id.

²⁹ See id.

³⁰ See id.

Further, one commenter expressed concern that the proposed rule change generally would relax margin requirements.³¹ Another commenter stated that entities should be responsible for their own risk, and that FINRA should not change margin requirements for entities that can effectively hedge any reasonable risk within the current market structure.³²

The Commission agrees that by conforming FINRA Rule 4210 with Cboe's new margin rules relating to protected options, the proposed rule change will promote regulatory harmonization with respect to use by customers of the protected option strategy. The proposed rule change also will help facilitate the use of protected options and reduce associated costs and burdens, while providing effective safeguards for the protection of investors and the public interest through the proposed conditions required as part of the protected options margin treatment. The proposed rule will permit customers of FINRA member broker-dealers (subject to the requirement that the deficiency not be greater than 5 percent) to post margin in the form of available equity in the margin account or cash or other marginable securities to remedy a deficiency. As a result, customers of broker-dealers will benefit from a reduction in transaction costs and improved operational efficiencies, in contrast to being required to purchase and deposit additional shares related to the underlying index, such as additional shares of an ETF, where the protection value is not at least equal to the aggregate underlying index. In addition, to the extent that equity in the margin account is utilized, customers will also benefit from a straightforward process from an operational standpoint with respect to

³¹ See Letter from Anonymous, Individual Investor (Oct. 9, 2023).

³² See Shanks Letter.

posting required margin.³³ Specifically, the proposed rule change will allow a customer to use collateral currently held in the customer's margin account to meet the conditions of the protected options margin, and therefore, the customer would not be required to post additional collateral (such as additional shares of an ETF) into the account to remedy a deficiency (provided there is sufficient equity in the account). The proposed rule change will, therefore, provide customers the flexibility to post other types of collateral (subject to the requirement that the deficiency not be greater than 5 percent) in the form of cash or other marginable securities, while continuing to require them to maintain sufficient levels of required margin for protected options, subject to the conditions in the proposed rule change.

Further, the securities (in addition to shares of ETFs) that customers will be permitted to post under the proposed rule change (subject to the requirement that the deficiency not be greater than 5 percent) must be margin eligible. This means that a broker-dealer can finance the customer's purchase of that security, and the customer can use the purchased margin security as collateral for the same purchase.³⁴ In addition, the proposed rule change prescribes margin requirements only for index options, i.e., protected options margin. Margin eligible securities (including ETFs) that customers

³³ See Cboe Approval Order at 14418-14419.

³⁴ For example, margin securities under the Board of Governors of the Federal Reserve System's Regulation T include, among others, any security registered or having unlisted trading privileges on a national securities exchange, any non-equity security, or any security issued by either an open-end investment company or unit investment trust which is registered under section 8 of the Investment Company Act of 1940. See 12 CFR 220.2. If a security is not a margin security, a customer cannot purchase it on margin, which means the customer must deposit 100 percent of the purchase price in their margin account. The classification of a margin security generally reflects the existence of an extensive public market for the security or recognition of requisite liquidity in the market for the security. See Charles F. Rechlin et al., Securities Credit Regulation § 3:7 (2d ed.).

hold in the same account as the index options and may post to meet the protected option margin requirements will continue to need to be fully paid for or be separately margined pursuant to the requirements of the Federal Reserve Board's Regulation T and FINRA Rule 4210 for those securities.³⁵

Further, the requirement to post margin on protected options or warrant positions that equals the greater of the in-the-money amount of the option or warrant, or the amount by which the aggregate current underlying index value exceeds the absolute value of the protection, while also requiring that the protection be at all times at least 95 percent of the aggregate current underlying index value addresses the risks associated with protected options or warrant positions (e.g., the risk of exercise of a short position when the option or warrant is in-the-money and tracking error). Therefore, this condition benefits both broker-dealers and customers by providing appropriate safeguards that address the risks associated with protected options, while offering a tailored margin approach with respect to the margin treatment for protected options.

Further, as discussed in section II. above, the proposed rule change also will expand the protected options margin requirements to unlisted, OTC options, so that these options are permitted the same margin treatment as listed options.³⁶ Amending Rule

³⁵ For example, Regulation T prescribes a 50 percent initial margin requirement for listed equity securities (meaning the customer must pay at least 50 percent of the market value of a listed equity security when purchasing it in a transaction financed by the broker-dealer and can use the purchased equity security as collateral for the same purchase). See 12 CFR 220.12(a). Regulation T only sets the initial margin requirements on equity securities, but Rule 4210 adds initial margin requirements on securities where Regulation T does not set specific requirements, such as for debt securities. Additionally, Rule 4210 specifies maintenance requirements that set a limit to the value that a customer's margin account can lose, such as 25 percent for listed equity securities. See Rule 4210(c).

³⁶ As discussed in section II. above, the protected option margin requirements only apply to listed options under Cboe's margin rules.

4210 to permit the protected options treatment to apply to both listed and unlisted OTC options will benefit market participants by allowing for consistent treatment between these option types (which will be subject to the same conditions), and thereby, facilitate trading in protected options.³⁷

Finally, FINRA stated that if the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice,³⁸ and that the effective date will be no later than 30 days following publication of the Regulatory Notice announcing Commission approval of the proposed rule change.³⁹ FINRA's proposed implementation schedule is appropriate, as market participants are aware of the Cboe Approval Order and the proposed rule change will reduce burdens for customers of broker-dealers by providing them a margin exception for protected options.

Accordingly, for the foregoing reasons, the Commission finds that this proposed rule change is consistent with the Exchange Act.

³⁷ FINRA stated it believes a small number of investors or members would choose to make use of the protected options treatment for either listed or unlisted options, and they would be limited to institutional investors. See Notice at 46206.

³⁸ See id. at 46205.

³⁹ See id. at 46205-46206.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,⁴⁰ that the proposed rule change (SR-FINRA-2023-010) is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴¹

J. Matthew DeLesDernier,

Deputy Secretary.

⁴⁰ 15 U.S.C. 78s(b)(2).

⁴¹ 17 CFR 200.30-3(a)(12).