

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * <input type="text" value="49"/>	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4	File No.* SR - <input type="text" value="2020"/> - * <input type="text" value="021"/>	Amendment No. (req. for Amendments *) <input type="text"/>
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Filing by Financial Industry Regulatory Authority
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * <input checked="" type="checkbox"/>	Amendment * <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) * <input type="checkbox"/>	Section 19(b)(3)(A) * <input checked="" type="checkbox"/>	Section 19(b)(3)(B) * <input type="checkbox"/>
Pilot <input type="checkbox"/>			Rule		
Extension of Time Period for Commission Action * <input type="checkbox"/>		Date Expires * <input type="text"/>	<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input checked="" type="checkbox"/> 19b-4(f)(6)	

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010	Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934
Section 806(e)(1) * <input type="checkbox"/>	Section 806(e)(2) * <input type="checkbox"/>
	Section 3C(b)(2) * <input type="checkbox"/>

Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
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Description

Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

Proposed Rule Change to Amend Rule 2360 (Options) to Increase Position Limits on Options on Certain Exchange-Traded Funds

Contact Information

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name * <input type="text" value="Kathryn"/>	Last Name * <input type="text" value="Moore"/>
Title * <input type="text" value="Associate General Counsel"/>	
E-mail * <input type="text" value="kathryn.moore@finra.org"/>	
Telephone * <input type="text" value="(202) 728-8200"/>	Fax <input type="text" value="(202) 728-8264"/>

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

(Title *)

Date <input type="text" value="07/14/2020"/>	Sr. Vice President & Director Capital Markets
By <input type="text" value="Stephanie Dumont"/>	Stephanie Dumont,

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFF website.

Form 19b-4 Information *

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ Financial Industry Regulatory Authority, Inc. (“FINRA”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend Rule 2360 (Options) to increase the position and exercise limits for conventional options on certain exchange-traded funds (“ETFs”).²

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

2360. Options

(a) No Change.

(b) Requirements

(1) through (2) No Change.

(3) Position Limits

(A) Stock Options —

(i) through (ii) No Change.

(iii) Conventional Equity Options

a. For purposes of this paragraph (b), standardized equity option contracts of the put class and call class on the

¹ 15 U.S.C. 78s(b)(1).

² Rule 2360(b)(4) sets forth exercise limits through incorporating by reference options position limits under the rule. Accordingly, although the proposed rule change would not amend the text of Rule 2360(b)(4), the proposed rule change also would correspondingly raise exercise limits on the option.

same side of the market overlying the same security shall not be aggregated with conventional equity option contracts or FLEX Equity Option contracts overlying the same security on the same side of the market. Conventional equity option contracts of the put class and call class on the same side of the market overlying the same security shall be subject to a position limit of:

1. through 5. No Change.

6. for selected conventional options on exchange-traded funds (“ETF”), the position limits are listed in the chart below:

Security Underlying Option	Position Limit
The DIAMONDS Trust (DIA)	300,000 contracts
The Standard and Poor’s Depository Receipts Trust (SPY)	[1,800,000] <u>3,600,000</u> contracts
The iShares Russell 2000 ETF (IWM)	1,000,000 contracts
The PowerShares QQQ Trust (QQQ)	1,800,000 contracts
The iShares MSCI Emerging Markets ETF (EEM)	1,000,000 contracts
iShares China Large-Cap ETF (FXI)	[500,000] <u>1,000,000</u> contracts
iShares MSCI EAFE ETF (EFA)	[500,000] <u>1,000,000</u> contracts
iShares MSCI Brazil Capped ETF (EWZ)	500,000 contracts
iShares 20+ Year Treasury Bond Fund ETF (TLT)	500,000 contracts
iShares MSCI Japan ETF (EWJ)	500,000 contracts
<u>iShares iBoxx High Yield Corporate Bond Fund (HYG)</u>	<u>500,000 contracts</u>
<u>Financial Select Sector SPDR Fund (XLF)</u>	<u>500,000 contracts</u>

b. No Change.

(B) through (D) No Change.

(4) through (24) No Change.

(c) No Change.

••• **Supplementary Material:** -----

.01 through .03 No Change.

* * * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The Chief Legal Officer of FINRA authorized the filing of the proposed rule change with the SEC pursuant to delegated authority. No other action by FINRA is necessary for the filing of the proposed rule change. FINRA has filed the proposed rule change for immediate effectiveness and has requested that the SEC waive the requirement that the proposed rule change not become operative for 30 days after the date of the filing, so FINRA can implement the proposed rule change immediately.

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

(a) Purpose

FINRA Rule 2360(b)(3)(A) imposes a position limit on the number of equity options contracts in each class on the same side of the market that can be held or written by a member, a person associated with a member, or a customer or a group of customers acting in concert. Position limits are intended to prevent the establishment of options positions that can be used to manipulate or disrupt the underlying market or might create incentives to manipulate or disrupt the underlying market so as to benefit the options position. In addition, position limits serve to reduce the potential for disruption of the

options market itself, especially in illiquid options classes.³ This consideration has been balanced by the concern that the limits “not be established at levels that are so low as to discourage participation in the options market by institutions and other investors with substantial hedging needs or to prevent specialists and market makers from adequately meeting their obligations to maintain a fair and orderly market.”⁴

Rule 2360(b)(3)(A)(i) does not independently establish a position limit for standardized equity options. Rather, the position limit established by the rules of an options exchange for a particular equity option is the applicable position limit for purposes of Rule 2360.⁵ Rule 2360(b)(3)(A)(iii) provides that conventional equity options⁶ are subject to a basic position limit of 25,000 contracts or a higher tier for conventional option contracts on securities that underlie exchange-traded options qualifying for such higher tier as determined by the rules of the options exchanges. In addition, FINRA lists position limits for options on securities that have higher position limits – currently, only the ETFs listed in Rule 2360(b)(3)(A)(iii)a.6. – that also generally mirror the options exchange position limits. At this time, FINRA proposes to conform its conventional options position limits to the Cboe Exchange, Inc.’s (“Cboe”) recent

³ See Securities Exchange Act Release No. 40969 (January 22, 1999), 64 FR 4911, 4912-4913 (February 1, 1999) (Order Approving File No. SR-CBOE-98-23) (citing H.R. No. IFC-3, 96th Cong., 1st Sess. at 189-91 (Comm. Print 1978)).

⁴ See supra at 4913.

⁵ See e.g., Cboe Rule 8.30; ISE Options 9 Section 13; NASDAQ PHLX Options 9 Section 13; NYSE American Rule 904; NYSE Arca Rule 6.8-0; MIAX Rule 307; BOX Rule 3120 and IM-3120-2; NASDAQ Options 9 Section 13; BX Options 9 Section 13; and BZX Rule 18.7.

⁶ Conventional options are over-the-counter options and are defined in Rule 2360(a)(9) as “(A) any option contract not issued, or subject to issuance, by The Options Clearing Corporation; or (B) an OCC Cleared OTC Option.”

amendments that increased the position limit options due to an ongoing increase in demand in options on the following ETFs: the Standard and Poor's Depository Receipts Trust ("SPY"), iShares MSCI EAFE ETF ("EFA"), iShares China Large-Cap ETF ("FXI"), iShares iBoxx High Yield Corporate Bond Fund ("HYG"), and Financial Select Sector SPDR Fund ("XLF" collectively, with the aforementioned ETFs, the "Underlying ETFs").⁷

The proposed rule change would amend the table provided in Rule 2360(b)(3)(A)(iii)a.6. as follows:

- The position limits for options on SPY would be increased from 1,800,000 contracts to 3,600,000 contracts;
- The position limit for options on EFA would be increased from 500,000 contracts to 1,000,000 contracts; and
- The position limit for options on FXI would be increased from 500,000 contracts to 1,000,000 contracts.

In addition, the proposed rule change would add to the table provided in Rule 2360(b)(3)(A)(iii)a.6. as follows, with the effect of each ETF being increased from the current position limit of 250,000 contracts:

⁷ See Securities Exchange Act Release No. 88768 (April 29, 2020), 85 FR 26736 (May 5, 2020) (Order Granting Approval of File No. SR-CBOE-2020-015). See also Securities Exchange Act Release No. 88893 (May 18, 2020), 85 FR 31239 (May 22, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-MIAX-2020-10) and Securities Exchange Act Release No. 88894 (May 18, 2020), 85 FR 31267 (May 22, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-BOX-2020-13).

- The position limit for options on HYG would be increased to 500,000 contracts; and
- The position limit for options on XLF would be increased to 500,000 contracts.

FINRA notes the proposed position limits on EFA and FXI are consistent with existing position limits for options on the iShares Russell 2000 ETF (“IWM”) and the iShares MSCI Emerging Markets ETF (“EEM”), and the proposed limits for options on XLF and HYG are consistent with current position limits for options on the iShares MSCI Brazil Capped ETF (“EWZ”), iShares 20+Year Treasury Bond Fund ETF (“TLT”), and iShares MSCI Japan ETF (“EWJ”).

In support of the proposed rule change, as noted by Cboe, position limits are determined by the option exchange’s rules.⁸ The ETFs that underlie options subject to the proposed rule change are highly liquid, and are based on a broad set of highly liquid securities and other reference assets. The above listed ETFs are listed on various national securities exchanges and meet their listing standards.

In supporting the proposed position limit increases, FINRA considered both liquidity of the Underlying ETFs and the component securities of the Underlying ETFs, as well as the availability of economically equivalent products to the overlying options and their respective position limits. For instance, some of the Underlying ETFs are based upon broad-based indices that underlie cash-settled options, and therefore the options on the Underlying ETFs are economically equivalent to the options on those indices, which have no position limits. Other Underlying ETFs are based upon broad-based indices that underlie cash-settled options with position limits reflecting notional values that are larger

⁸ See e.g., Cboe Rule 8.30, Interpretation and Policy .02.

than current position limits for options on the ETF analogues. For indexes that are tracked by an Underlying ETF but on which there are no options listed, FINRA believes, based on the liquidity, depth and breadth of the underlying market of the components of the indexes, that each of the indexes referenced by the applicable ETFs would be considered a broad-based index under options exchange rules. Additionally, if in some cases certain position limits are appropriate for the options overlying comparable indexes or basket of securities that the Underlying ETFs track then those economically equivalent position limits should be appropriate for the options overlying the Underlying ETFs.

FINRA notes that Cboe has compiled the following trading statistics regarding shares of and exchange-traded options on the Underlying ETFs, as well as the component securities or components underlying the referenced index (as applicable):⁹

Product	ADV (ETF shares) (in millions)	ADV (option contracts)	Shares Outstanding (ETFs) (in millions)	Fund Market Cap (USD)	Total Market Cap of ETF Components
SPY	70.3	2.8 million	968.7	312.9 billion	29.3 trillion
FXI	26.1	196,600	106.8	4.8 billion	28.0 trillion
EFA	25.1	155,900	928.2	64.9 billion	19.3 trillion
HYG	20.0	193,700	216.6	19.1 billion	906.4 billion

⁹ See note 7. As noted above, the position limit for standardized options under Rule 2360 is the limit established by an exchange on which the option trades. The position limit for conventional options under Rule 2360 generally mirrors the options exchange position. The proposed rule change would maintain consistent position limits between standardized and conventional options on the same underlying security. FINRA believes that the Cboe reasoning regarding the increase to standardized options position limits applies equally to increasing the position limit for conventional options.

XLF	48.8	102,100	793.6	24.6 billion	3.8 trillion
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Further, Cboe has collected the same trading statistics, where applicable, as above regarding a sample of other ETFs, as well as the current position limits for options on such ETFs, to draw comparisons in support of proposed position limit increases for options on a number of the Underlying ETFs:

Product	ADV (ETF shares) (in millions)	ADV (option contracts)	Shares Outstanding (ETFs) (in millions)	Fund Market Cap (USD)	Total Market Cap of ETF Components	Current Position Limit
QQQ	30.2	670,200	410.3	88.7 billion	10.1 trillion	1,800,000
EWZ	26.7	186,500	233	11.3 billion	234.6 billion	500,000
TLT	9.6	95,200	128.1	17.5 billion	N/A	500,000
EWJ	7.2	5,700	236.6	14.2 billion	3 trillion	500,000

FINRA agrees with Cboe that, overall, the liquidity in the shares of the Underlying ETFs and in the component securities of the Underlying ETFs, and in their overlying options, as well as the large market capitalizations and structure of each of the Underlying ETFs, support the proposal to increase the position limits for each option class. Given the robust liquidity and capitalization in the Underlying ETFs and in the component securities of the Underlying ETFs, FINRA believes the market capitalization of the underlying component securities of the applicable ETF is large enough to adequately absorb potential price movements that may be caused by large trades. The following analyses for the Underlying ETFs, which FINRA agrees with in support of the

proposed rule change, as well as the statistics presented in support thereof, were presented by Cboe in their initial filing, which was approved by the Commission.

Specifically, Cboe notes that SPY tracks the performance of the S&P 500® Index, which is an index of diversified large cap U.S. companies.¹⁰ It is composed of 505 selected stocks spanning over approximately 24 separate industry groups. The S&P 500® is one of the most commonly followed equity indices, and is widely considered to be the best indicator of stock market performance as a whole. SPY is one of the most actively traded ETFs, and, since 2017, its ADV has increased from approximately 64.6 million shares to 70.3 million shares by the end of 2019. Similarly, its ADV in options contracts has increased from 2.6 million to 2.8 million through 2019. As noted, the demand for options trading on SPY has continued to increase, however, the position limits have remained the same, which may have impacted growth in SPY option volume from 2017 through 2019. SPY shares are more liquid than PowerShares QQQ Trust (“QQQ”) shares, which is also currently subject to a position limit of 1,800,000 contracts. Specifically, SPY currently experiences over twice the ADV in shares and over four times the ADV in options than that of QQQ.

EFA tracks the performance of MSCI EAFE Index, which is composed of over 900 large and mid-cap securities across 21 developed markets, including countries in Europe, Australia and the Far East, excluding the U.S. and Canada.¹¹ From 2017 through

¹⁰ See SPDR® S&P 500® ETF Trust, available at <https://www.ssga.com/us/en/individual/etfs/funds/spdr-sp-500-etf-trust-spy> (January 21, 2020).

¹¹ See iShares MSCI EAFE ETF, available at <https://www.ishares.com/us/products/239623/ishares-msci-eafe-etf> (February 10, 2020).

2019, ADV has grown significantly in shares of EFA and in options on EFA, from approximately 19.4 million shares in 2017 to 25.1 million through 2019, and from approximately 98,800 options contract in 2017 to 155,900 through 2019. Options are available on the MSCI EAFE Index (“MXEA”), the analogue index, which was previously subject to a position limit of 25,000 contracts (50,000 as proposed by Cboe and approved the Commission).¹² Using the notional value comparison of EFA’s share price of \$69.44 and MXEA’s index level of 2036.94, approximately 29 EFA option contracts equal one MXEA option contract.¹³ Based on the above comparison of notional values, a position limit for EFA options that would be economically equivalent to that of MXEA options equates to 725,000 contracts (previously) and 1,450,000 (for the Cboe proposed 50,000 contracts position limit increase for MXEA options that was approved by the Commission). Also, MXEA index options have an ADV of 594 options contracts, in which equate to an ADV of 17,226 EFA option contracts (as that is 29 times the size of 594). EFA options, which are more actively traded and held than MXEA options, are currently subject to a position limit of 500,000 options contracts despite their much higher ADV of approximately 155,900 options contracts.

¹² See note 7. Cboe raised the position limit on certain indexes. FINRA incorporates by reference the exchange position limits on indexes in FINRA Rule 2360(b)(3)(B) and accordingly does not need to propose any corresponding FINRA rule change.

¹³ See note 7. The values were presented by Cboe in their initial filing, which was approved by the Commission.

FXI tracks the performance of the FTSE China 50 Index, which is composed of the 50 largest Chinese stocks.¹⁴ FXI shares and options have also experienced increased liquidity since 2017, as ADV has grown from approximately 15.1 million shares in 2017 to 26.1 million through 2019, as well as approximately 71,900 options contracts in 2017 to 196,600 through 2019. Although there are currently no options on the FTSE China 50 Index listed for trading, the components of the FTSE China 50 Index, which can be used to create a basket of stocks that equate to the FXI ETF, currently have a market capitalization of approximately \$28 trillion and FXI has a market capitalization of \$4.8 billion (as indicated above), which are both large enough to absorb potential price movements caused by a large trade in FXI.

XLFF invests in a wide array of financial service firms with diversified business lines ranging from investment management to commercial and investment banking. It generally corresponds to the price and yield performance of publicly traded equity securities of companies in the SPDR Financial Select Sector Index.¹⁵ XLFF experiences ADV in shares and in exchange-traded options (48.8 million shares and 102,100 options contracts) that is significantly greater than the ADV in shares and options for EWZ (26.7 million shares and 186,500 options contracts), TLT (9.6 million shares and 95,200 options contracts), and EWJ (7.2 million shares and 5,700 options contracts), each of which already have a position limit of 500,000 contracts – the proposed position limit for XLFF options. Although there are no options on the SPDR Financial Select Sector Index

¹⁴ See iShares China Large-Cap ETF, available at <https://www.ishares.com/us/products/239536/ishares-china-largecap-etf> (February 10, 2020).

¹⁵ See Select Sector SPDR ETFs, XLFF, available at <http://www.sectorspdr.com/sectorspdr/sector/xlf> (January 15, 2020).

listed for trading, the components of the index, which can be used to create a basket of stocks that equate to the XLF ETF, currently have a market capitalization of \$3.8 trillion (indicated above). Additionally, XLF has a market capitalization of \$24.6 billion. Both of these are large enough to absorb potential price movements caused by a large trade in XLF.

Finally, HYG attempts to track the investment results of Markit iBoxx USD Liquid High Yield Index, which is composed of U.S. dollar-denominated, high-yield corporate bonds and is one of the most widely used high-yield bond ETFs.¹⁶ HYG experiences significantly higher ADV in shares and exchange-traded options (20 million shares and 193,700 options contracts) than both TLT (9.6 million shares and 95,200 options contracts), and EWJ (7.2 million shares and 5,700 options contracts), which are currently subject to a position limit of 500,000 options contracts – the proposed limit for options on HYG. While HYG does not have an index option analogue listed for trading, FINRA agrees with Cboe’s belief that HYG’s market capitalization of \$19.1 billion, and of \$906.4 billion in component securities, is adequate to absorb a potential price movement that may be caused by large trades in HYG.

FINRA believes that increasing the position limits for conventional options subject to the proposed rule change would lead to a more liquid and competitive market for these options, which will benefit customers interested in these products.

¹⁶ See iShares iBoxx \$ High Yield Corporate Bond ETF, available at <https://www.ishares.com/us/products/239565/ishares-iboxx-high-yield-corporatebond-etf> (January 15, 2020).

Creation and Redemption for ETFs

FINRA believes that the creation and redemption process for ETFs will lessen the potential for manipulative activity with options on the Underlying ETFs. When an ETF provider wants to create more shares, it looks to an Authorized Participant (generally a market maker or other large financial institution) to acquire the securities the ETF is to hold. For instance, when an ETF is designed to track the performance of an index, the Authorized Participant can purchase all the constituent securities in the exact same weight as the index, then deliver those shares to the ETF provider. In exchange, the ETF provider gives the Authorized Participant a block of equally valued ETF shares, on a one-for-one fair value basis. The price is based on the net asset value, not the market value at which the ETF is trading. The creation of new ETF units can be conducted during an entire trading day, and is not subject to position limits. This process works in reverse where the ETF provider seeks to decrease the number of shares that are available to trade. The creation and redemption process, therefore, creates a direct link to the underlying components of the ETF, and serves to mitigate potential price impact of the ETF shares that might otherwise result from increased position limits for the ETF options.

FINRA understands that the ETF creation and redemption process seeks to keep an ETF's share price trading in line with the ETF's underlying net asset value. Because an ETF trades like a stock, its share price will fluctuate during the trading day, due to simple supply and demand. If demand to buy an ETF is high, for instance, the ETF's share price might rise above the value of its underlying securities. When this happens, the Authorized Participant believes the ETF may now be overpriced, so it may buy shares of the component securities and then sell ETF shares in the open market (i.e. creations).

This may drive the ETF's share price back toward the underlying net asset value.

Likewise, if the ETF share price starts trading at a discount to the securities it holds, the Authorized Participant can buy shares of the ETF and redeem them for the underlying securities (i.e. redemptions). Buying undervalued ETF shares may drive the share price of the ETF back toward fair value. This arbitrage process helps to keep an ETF's share price in line with the value of its underlying portfolio.

Surveillance and Reporting

FINRA believes that the increased position limits provisions are appropriate in light of the existing surveillance procedures and reporting requirements at FINRA,¹⁷ the options exchanges, and at the several clearing firms, which are capable of properly identifying unusual or illegal trading activity. These procedures use daily monitoring of market movements by automated surveillance techniques to identify unusual activity in both options and underlying stocks.¹⁸

In addition, large stock holdings must be disclosed to the Commission by way of Schedules 13D or 13G.¹⁹ Options positions are part of any reportable positions and cannot legally be hidden. Moreover, the previously noted Rule 2360(b)(5) requirement that members must file reports with FINRA for any customer that held aggregate large long or short positions of any single class for the previous day will continue to serve as an important part of FINRA's surveillance efforts.

¹⁷ See Rule 2360(b)(5) for the options reporting requirements.

¹⁸ These procedures have been effective for the surveillance of options trading and will continue to be employed.

¹⁹ 17 CFR 240.13d-1.

Finally, FINRA believes that the current financial requirements imposed by FINRA and by the Commission adequately address financial responsibility concerns that a member or its customer will maintain an inordinately large unhedged position in any option with a higher position limit. Current margin and risk-based haircut methodologies serve to limit the size of positions maintained by any one account by increasing the margin or capital that a member must maintain for a large position. Under Rule 4210(f)(8)(A), FINRA also may impose a higher margin requirement upon a member when FINRA determines a higher requirement is warranted. In addition, the Commission's net capital rule²⁰ imposes a capital charge on members to the extent of any margin deficiency resulting from the higher margin requirement.

As noted in Item 2 of this filing, FINRA has filed the proposed rule change for immediate effectiveness and has requested that the SEC waive the requirement that the proposed rule change not become operative for 30 days after the date of the filing, so FINRA can implement the proposed rule change immediately.

(b) Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,²¹ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change promotes consistent regulation by harmonizing position limits with those of the other self-regulatory organizations.

²⁰ 17 CFR 240.15c3-1.

²¹ 15 U.S.C. 78q-3(b)(6).

FINRA further believes that increasing the position limit on conventional options promotes consistent regulation by harmonizing the position limit with its standardized counterpart. In addition, FINRA believes the proposed rule change will be beneficial to large market makers and institutions (which generally have the greatest ability to provide liquidity and depth in products that may be subject to higher position limits as has been the case with recently approved increased position limits),²² as well as retail traders and public customers, by providing them with a more effective trading and hedging vehicle.

In addition, FINRA believes that the structure of the Underlying ETFs, the considerable market capitalization of the funds, underlying component securities, and the liquidity of the markets for the applicable options and underlying component securities will mitigate concerns regarding potential manipulation of the products or disruption of the underlying markets upon increasing the relevant position limits. As a general principle, increases in market capitalizations, active trading volume, and deep liquidity of securities tend to deter manipulation or disruption. This general principle applies to the recently observed increased levels of market capitalization, trading volume, and liquidity in shares of the Underlying ETFs, and the components of the Underlying ETFs (as described above). FINRA does not believe that the options markets or underlying markets would become susceptible to manipulation or disruption as a result of the proposed position limit increases.

Increased position limits for select actively traded options, such as those proposed herein, are not novel and have been previously approved by the Commission. For example, a position limit of 1,800,000 contracts on options on SPY has been

²² See note 7.

established.²³ Additionally, the Commission has approved similar proposed rule changes by the options exchanges to increase position and exercise limits for options on highly liquid, actively traded ETFs.²⁴ Furthermore, the proposed position limits on EFA and FXI are consistent with existing position limits for options on IWM and EEM, and the proposed limits for options on XLF and HYG are consistent with current position limits for options on EWZ, TLT and EWJ.

²³ See Securities Exchange Act Release No. 83349 (May 30, 2018), 83 FR 26123 (June 5, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-MIAX-2018-11). See also Securities Exchange Act Release No. 83412 (June 12, 2018), 83 FR 28298 (June 18, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-PHLX-2018-44); Securities Exchange Act Release No. 83414 (June 12, 2018), 83 FR 28296 (June 18, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-BOX-2018-22); Securities Exchange Act Release No. 83415 (June 12, 2018), 83 FR 28274 (June 18, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-CBOE-2018-042); Securities Exchange Act Release No. 83413 (June 12, 2018), 83 FR 28277 (June 18, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-NYSEArca-2018-44) and Securities Exchange Act Release No. 83417 (June 12, 2018), 83 FR 28279 (June 18, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-NYSEAMER-2018-26).

²⁴ See note 5. See also Securities Exchange Act Release No. 68086 (October 23, 2012), 77 FR 65600 (October 29, 2012) (Order Approving File No. SR-CBOE-2012-66); Securities Exchange Act Release No. 68478 (December 19, 2012), 77 FR 76132 (December 26, 2012) (Notice of Filing and Immediate Effectiveness of File No. SR-BOX-2012-23); Securities Exchange Act Release No. 68398 (December 11, 2012), 77 FR 74700 (December 17, 2012) (Notice of Filing and Immediate Effectiveness of File No. SR-ISE-2012-93); Securities Exchange Act Release No. 68293 (November 27, 2012), 77 FR 71644 (December 3, 2012) (Notice of Filing and Immediate Effectiveness of File No. SR-Phlx-2012-132); Securities Exchange Act Release No. 68358 (December 5, 2012), 77 FR 73708 (December 11, 2012) (Notice of Filing and Immediate Effectiveness of File No. SR-NYSE MKT-2012-71); Securities Exchange Act Release No. 68359 (December 5, 2012), 77 FR 73716 (December 11, 2012) (Notice of Filing and Immediate Effectiveness of File No. SR-NYSEArca-2012-132) and Securities Exchange Act Release No. 69457 (April 25, 2013), 78 FR 25502 (May 1, 2013) (Notice of Filing and Immediate Effectiveness of File No. SR-MIAX-2013-17).

FINRA's existing surveillance and reporting safeguards are designed to deter and detect possible manipulative behavior that might arise from changing position and exercise limits.

4. 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 Act.

Economic Impact Analysis

FINRA has undertaken an economic impact assessment, as set forth below, to analyze the potential economic impacts, including anticipated costs, benefits, and distributional and competitive effects transfers of wealth, relative to the current baseline, and the alternatives FINRA considered in assessing how to best meet its regulatory objectives.

Regulatory Objective

FINRA is proposing to amend Rule 2360 to harmonize FINRA's position limits for conventional options with the position limit for standardized options.²⁵

Economic Baseline

Per FINRA Rule 2360(b)(3)(A)(iii) conventional equity options are subject to a basic position limit of 25,000 contracts or higher for conventional option contracts on securities that underlie exchange-traded options qualifying for a higher tier as determined by option exchange rules. The existing position limits for conventional options on ETFs are: 1,800,000 contracts for SPY, 500,000 contracts for EFA or FXI and 250,000

²⁵ See note 7.

contracts for HYG or XLF. Cboe has recently increased position limit options on these ETFs.

Economic Impact

Benefits

As noted above, the proposed rule change would amend Rule 2360 to harmonize FINRA's position limits for conventional options with the position limits for standardized options.²⁶ If the existing position limits for conventional equity options on select ETFs constrains trading in these ETFs, then investors may be able to better manage risk and trade on information when the position limit is relaxed. In general, the improvement in risk management and informational efficiency may increase more when position limits are increased. FINRA acknowledges, however, that the conventional options on these ETFs, the ETFs themselves, and the securities underlying these ETFs are liquid, so improvements in informational efficiency may be relatively small.

For investors that trade conventional equity options, there is likely to be a natural size for an executed order that minimizes fixed and variable transaction costs, including but not limited to, the bid-ask spread, price impact, and transaction fees. If the existing position limits for conventional equity options on select ETFs constrains the order size such that fixed and variable transaction costs are higher than optimal, then investors may benefit if the new position limit is no less than the natural size. In such an event, the cost to hedge an ETF would decline, thereby making it less costly to manage downside risk.

In addition, if the existing position limits serve as a constraint, then an increase in the position limits for conventional options on select ETFs could permit investors to more

²⁶ See note 7.

easily find a counterparty. If the number of counterparties increases, then the cost of hedging should decline as the half-spread narrows, thereby making it less expensive to manage downside risk.

The extent of the constraint imposed by the current limit on conventional options is related to the ability of an investor to achieve similar economic exposure through other means. If there are other securities, such as an option on a closely related index, that exist and provide similar economic exposure less expensively, then the value of lessening the position limits on conventional options on ETFs is lower.

Members may rely on information and data feeds from the Options Clearing Corporation to assist in their monitoring position limits. Because position limits on the standardized and conventional side have traditionally been consistent, members have relied on this feed for both standardized and conventional options. If the position limits between standardized and conventional options are conformed, then the cost from monitoring position limits should decline for member firms. Having the same position limits on standardized and conventional options, reduces the potential for excess loss that may be incurred when different limits are applied to the standardized versus conventional options on the same ETF. The economic loss may arise from building and maintaining trading and compliance systems to support the different regimes. Furthermore, the harmonization of position limits on standardized and conventional options eliminates the potential risk and cost arising from regulatory arbitrage.

Costs

The proposed rule change may impose limited operational cost on member firms that trade conventional options on ETFs, as these same firms would need to revise

position limits that are used in trading systems. However, the proposed rule change should not impose additional costs, because it is difficult to disrupt or manipulate the underlying market, create an incentive to disrupt or manipulate the underlying market for the purpose of profiting from the options position, or disrupt or manipulate the options market for conventional options on ETFs affected by this proposed rule. ETFs that underlie options subject to the proposed rule change are highly liquid and are based on a broad set of highly liquid securities, which makes the market difficult to manipulate or disrupt. In fact, options on certain broad-based security indexes have no position limits. Furthermore, the creation and redemption process for these ETFs reduces the potential for disruptive or manipulative activity. New ETF units may be created at any time during the trading day and are not subject to position limits. Consequently, there is a direct link between the underlying components of the ETF and the ETF, which keeps the ETF's share prices trading in line with the ETF's underlying net asset value.

Alternatives

No further alternatives are under consideration.

5. **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.

6. **Extension of Time Period for Commission Action**

Not applicable.

7. **Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)**

The proposed rule change is effective upon filing pursuant to Section 19(b)(3) of the Act²⁷ and paragraph (f)(6) of Rule 19b-4 thereunder,²⁸ in that the proposed rule change does not significantly affect the protection of investors or the public interest; does not impose any significant burden on competition; and does not become operative for 30 days after filing or such shorter time as the Commission may designate. The proposed rule change is based on the Cboe rule as noted in Item 8 below, and thus would ensure consistent regulation with respect to position limits (and exercise limits)²⁹ for ETF options noted above as such may be established by an options exchange as approved by the SEC for the protection of investors and the public interest.

FINRA requests that the Commission waive the requirement that the rule change, by its terms, not become operative for 30 days after the date of the filing as set forth in Rule 19b-4(f)(6)(iii),³⁰ so FINRA may immediately harmonize position limits with those of other self-regulatory organizations to ensure consistent regulation for the protection of investors and the public interest. In accordance with Rule 19b-4(f)(6),³¹ FINRA submitted written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the

²⁷ 15 U.S.C. 78s(b)(3).

²⁸ 17 CFR 240.19b-4(f)(6).

²⁹ See note 7. Rule 2360(b)(4) sets forth exercise limits through incorporating by reference options position limits under the rule. Accordingly, although the proposed rule change would not amend the text of Rule 2360(b)(4), the proposed rule change also would correspondingly raise exercise limits on the option.

³⁰ 17 CFR 240.19b-4(f)(6)(iii).

³¹ 17 CFR 240.19b-4(f)(6).

date of filing, or such shorter time as the Commission may designate, as specified in Rule 19b-4(f)(6)(iii) under the Act.³²

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

See Cboe Rule 8.30.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

Exhibit 1. Completed notice of proposed rule change for publication in the Federal Register.

³² 17 CFR 240.19b-4(f)(6)(iii).

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-FINRA-2020-021)

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Amend Rule 2360 (Options) to Increase Position Limits on Options on Certain Exchange-Traded Funds

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 , 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. FINRA has designated the proposed rule change as constituting a “non-controversial” rule change under paragraph (f)(6) of Rule 19b-4 under the Act,³ which renders the proposal effective upon receipt of this filing by the Commission. 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 Rule 2360 (Options) to increase the position and exercise limits for conventional options on certain exchange-traded funds (“ETFs”).

Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR 240.19b-4(f)(6).

* * * * *

2360. Options

(a) No Change.

(b) Requirements

(1) through (2) No Change.

(3) Position Limits

(A) Stock Options —

(i) through (ii) No Change.

(iii) Conventional Equity Options

a. For purposes of this paragraph (b), standardized equity option contracts of the put class and call class on the same side of the market overlying the same security shall not be aggregated with conventional equity option contracts or FLEX Equity Option contracts overlying the same security on the same side of the market. Conventional equity option contracts of the put class and call class on the same side of the market overlying the same security shall be subject to a position limit of:

1. through 5. No Change.

6. for selected conventional options on exchange-traded funds (“ETF”), the position limits are listed in the chart below:

Security Underlying Option	Position Limit
The DIAMONDS Trust (DIA)	300,000 contracts
The Standard and Poor's Depository Receipts Trust (SPY)	[1,800,000] <u>3,600,000</u> contracts
The iShares Russell 2000 ETF (IWM)	1,000,000 contracts
The PowerShares QQQ Trust (QQQ)	1,800,000 contracts
The iShares MSCI Emerging Markets ETF (EEM)	1,000,000 contracts
iShares China Large-Cap ETF (FXI)	[500,000] <u>1,000,000</u> contracts
iShares MSCI EAFE ETF (EFA)	[500,000] <u>1,000,000</u> contracts
iShares MSCI Brazil Capped ETF (EWZ)	500,000 contracts
iShares 20+ Year Treasury Bond Fund ETF (TLT)	500,000 contracts
iShares MSCI Japan ETF (EWJ)	500,000 contracts
iShares iBoxx High Yield Corporate Bond Fund (HYG)	<u>500,000 contracts</u>
<u>Financial Select Sector SPDR Fund (XLF)</u>	<u>500,000 contracts</u>

b. No Change.

(B) through (D) No Change.

(4) through (24) No Change.

(c) No Change.

••• **Supplementary Material:** -----

.01 through .03 No Change.

* * * * *

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

FINRA Rule 2360(b)(3)(A) imposes a position limit on the number of equity options contracts in each class on the same side of the market that can be held or written by a member, a person associated with a member, or a customer or a group of customers acting in concert. Position limits are intended to prevent the establishment of options positions that can be used to manipulate or disrupt the underlying market or might create incentives to manipulate or disrupt the underlying market so as to benefit the options position. In addition, position limits serve to reduce the potential for disruption of the options market itself, especially in illiquid options classes.⁴ This consideration has been balanced by the concern that the limits “not be established at levels that are so low as to discourage participation in the options market by institutions and other investors with substantial hedging needs or to prevent specialists and market makers from adequately meeting their obligations to maintain a fair and orderly market.”⁵

Rule 2360(b)(3)(A)(i) does not independently establish a position limit for standardized equity options. Rather, the position limit established by the rules of an options exchange for a particular equity option is the applicable position limit for

⁴ See Securities Exchange Act Release No. 40969 (January 22, 1999), 64 FR 4911, 4912-4913 (February 1, 1999) (Order Approving File No. SR-CBOE-98-23) (citing H.R. No. IFC-3, 96th Cong., 1st Sess. at 189-91 (Comm. Print 1978)).

⁵ See supra at 4913.

purposes of Rule 2360.⁶ Rule 2360(b)(3)(A)(iii) provides that conventional equity options⁷ are subject to a basic position limit of 25,000 contracts or a higher tier for conventional option contracts on securities that underlie exchange-traded options qualifying for such higher tier as determined by the rules of the options exchanges. In addition, FINRA lists position limits for options on securities that have higher position limits – currently, only the ETFs listed in Rule 2360(b)(3)(A)(iii)a.6. – that also generally mirror the options exchange position limits. At this time, FINRA proposes to conform its conventional options position limits to the Cboe Exchange, Inc.’s (“Cboe”) recent amendments that increased the position limit options due to an ongoing increase in demand in options on the following ETFs: the Standard and Poor’s Depository Receipts Trust (“SPY”), iShares MSCI EAFE ETF (“EFA”), iShares China Large-Cap ETF (“FXI”), iShares iBoxx High Yield Corporate Bond Fund (“HYG”), and Financial Select Sector SPDR Fund (“XLF” collectively, with the aforementioned ETFs, the “Underlying ETFs”).⁸

⁶ See e.g., Cboe Rule 8.30; ISE Options 9 Section 13; NASDAQ PHLX Options 9 Section 13; NYSE American Rule 904; NYSE Arca Rule 6.8-0; MIAX Rule 307; BOX Rule 3120 and IM-3120-2; NASDAQ Options 9 Section 13; BX Options 9 Section 13; and BZX Rule 18.7.

⁷ Conventional options are over-the-counter options and are defined in Rule 2360(a)(9) as “(A) any option contract not issued, or subject to issuance, by The Options Clearing Corporation; or (B) an OCC Cleared OTC Option.”

⁸ See Securities Exchange Act Release No. 88768 (April 29, 2020), 85 FR 26736 (May 5, 2020) (Order Granting Approval of File No. SR-CBOE-2020-015). See also Securities Exchange Act Release No. 88893 (May 18, 2020), 85 FR 31239 (May 22, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-MIAX-2020-10) and Securities Exchange Act Release No. 88894 (May 18, 2020), 85 FR 31267 (May 22, 2020) (Notice of Filing and Immediate Effectiveness of File No. SR-BOX-2020-13).

The proposed rule change would amend the table provided in Rule 2360(b)(3)(A)(iii)a.6. as follows:

- The position limits for options on SPY would be increased from 1,800,000 contracts to 3,600,000 contracts;
- The position limit for options on EFA would be increased from 500,000 contracts to 1,000,000 contracts; and
- The position limit for options on FXI would be increased from 500,000 contracts to 1,000,000 contracts.

In addition, the proposed rule change would add to the table provided in Rule 2360(b)(3)(A)(iii)a.6. as follows, with the effect of each ETF being increased from the current position limit of 250,000 contracts:

- The position limit for options on HYG would be increased to 500,000 contracts; and
- The position limit for options on XLF would be increased to 500,000 contracts.

FINRA notes the proposed position limits on EFA and FXI are consistent with existing position limits for options on the iShares Russell 2000 ETF (“IWM”) and the iShares MSCI Emerging Markets ETF (“EEM”), and the proposed limits for options on XLF and HYG are consistent with current position limits for options on the iShares MSCI Brazil Capped ETF (“EWZ”), iShares 20+Year Treasury Bond Fund ETF (“TLT”), and iShares MSCI Japan ETF (“EWJ”).

In support of the proposed rule change, as noted by Cboe, position limits are determined by the option exchange’s rules.⁹ The ETFs that underlie options subject to

⁹ See e.g., Cboe Rule 8.30, Interpretation and Policy .02.

the proposed rule change are highly liquid, and are based on a broad set of highly liquid securities and other reference assets. The above listed ETFs are listed on various national securities exchanges and meet their listing standards.

In supporting the proposed position limit increases, FINRA considered both liquidity of the Underlying ETFs and the component securities of the Underlying ETFs, as well as the availability of economically equivalent products to the overlying options and their respective position limits. For instance, some of the Underlying ETFs are based upon broad-based indices that underlie cash-settled options, and therefore the options on the Underlying ETFs are economically equivalent to the options on those indices, which have no position limits. Other Underlying ETFs are based upon broad-based indices that underlie cash-settled options with position limits reflecting notional values that are larger than current position limits for options on the ETF analogues. For indexes that are tracked by an Underlying ETF but on which there are no options listed, FINRA believes, based on the liquidity, depth and breadth of the underlying market of the components of the indexes, that each of the indexes referenced by the applicable ETFs would be considered a broad-based index under options exchange rules. Additionally, if in some cases certain position limits are appropriate for the options overlying comparable indexes or basket of securities that the Underlying ETFs track then those economically equivalent position limits should be appropriate for the options overlying the Underlying ETFs.

FINRA notes that Cboe has compiled the following trading statistics regarding shares of and exchange-traded options on the Underlying ETFs, as well as the component securities or components underlying the referenced index (as applicable):¹⁰

Product	ADV (ETF shares) (in millions)	ADV (option contracts)	Shares Outstanding (ETFs) (in millions)	Fund Market Cap (USD)	Total Market Cap of ETF Components
SPY	70.3	2.8 million	968.7	312.9 billion	29.3 trillion
FXI	26.1	196,600	106.8	4.8 billion	28.0 trillion
EFA	25.1	155,900	928.2	64.9 billion	19.3 trillion
HYG	20.0	193,700	216.6	19.1 billion	906.4 billion
XLF	48.8	102,100	793.6	24.6 billion	3.8 trillion

Further, Cboe has collected the same trading statistics, where applicable, as above regarding a sample of other ETFs, as well as the current position limits for options on such ETFs, to draw comparisons in support of proposed position limit increases for options on a number of the Underlying ETFs:

¹⁰ See note 8. As noted above, the position limit for standardized options under Rule 2360 is the limit established by an exchange on which the option trades. The position limit for conventional options under Rule 2360 generally mirrors the options exchange position. The proposed rule change would maintain consistent position limits between standardized and conventional options on the same underlying security. FINRA believes that the Cboe reasoning regarding the increase to standardized options position limits applies equally to increasing the position limit for conventional options.

Product	ADV (ETF shares) (in millions)	ADV (option contracts)	Shares Outstanding (ETFs) (in millions)	Fund Market Cap (USD)	Total Market Cap of ETF Components	Current Position Limit
QQQ	30.2	670,200	410.3	88.7 billion	10.1 trillion	1,800,000
EWZ	26.7	186,500	233	11.3 billion	234.6 billion	500,000
TLT	9.6	95,200	128.1	17.5 billion	N/A	500,000
EWJ	7.2	5,700	236.6	14.2 billion	3 trillion	500,000

FINRA agrees with Cboe that, overall, the liquidity in the shares of the Underlying ETFs and in the component securities of the Underlying ETFs, and in their overlying options, as well as the large market capitalizations and structure of each of the Underlying ETFs, support the proposal to increase the position limits for each option class. Given the robust liquidity and capitalization in the Underlying ETFs and in the component securities of the Underlying ETFs, FINRA believes the market capitalization of the underlying component securities of the applicable ETF is large enough to adequately absorb potential price movements that may be caused by large trades. The following analyses for the Underlying ETFs, which FINRA agrees with in support of the proposed rule change, as well as the statistics presented in support thereof, were presented by Cboe in their initial filing, which was approved by the Commission.

Specifically, Cboe notes that SPY tracks the performance of the S&P 500® Index, which is an index of diversified large cap U.S. companies.¹¹ It is composed of 505

¹¹ See SPDR® S&P 500® ETF Trust, available at <https://www.ssga.com/us/en/individual/etfs/funds/spdr-sp-500-etf-trust-spy> (January 21, 2020).

selected stocks spanning over approximately 24 separate industry groups. The S&P 500® is one of the most commonly followed equity indices, and is widely considered to be the best indicator of stock market performance as a whole. SPY is one of the most actively traded ETFs, and, since 2017, its ADV has increased from approximately 64.6 million shares to 70.3 million shares by the end of 2019. Similarly, its ADV in options contracts has increased from 2.6 million to 2.8 million through 2019. As noted, the demand for options trading on SPY has continued to increase, however, the position limits have remained the same, which may have impacted growth in SPY option volume from 2017 through 2019. SPY shares are more liquid than PowerShares QQQ Trust (“QQQ”) shares, which is also currently subject to a position limit of 1,800,000 contracts. Specifically, SPY currently experiences over twice the ADV in shares and over four times the ADV in options than that of QQQ.

EFA tracks the performance of MSCI EAFE Index, which is composed of over 900 large and mid-cap securities across 21 developed markets, including countries in Europe, Australia and the Far East, excluding the U.S. and Canada.¹² From 2017 through 2019, ADV has grown significantly in shares of EFA and in options on EFA, from approximately 19.4 million shares in 2017 to 25.1 million through 2019, and from approximately 98,800 options contract in 2017 to 155,900 through 2019. Options are available on the MSCI EAFE Index (“MXEA”), the analogue index, which was previously subject to a position limit of 25,000 contracts (50,000 as proposed by Cboe

¹² See iShares MSCI EAFE ETF, available at <https://www.ishares.com/us/products/239623/ishares-msci-eafe-etf> (February 10, 2020).

and approved the Commission).¹³ Using the notional value comparison of EFA's share price of \$69.44 and MXEA's index level of 2036.94, approximately 29 EFA option contracts equal one MXEA option contract.¹⁴ Based on the above comparison of notional values, a position limit for EFA options that would be economically equivalent to that of MXEA options equates to 725,000 contracts (previously) and 1,450,000 (for the Cboe proposed 50,000 contracts position limit increase for MXEA options that was approved by the Commission). Also, MXEA index options have an ADV of 594 options contracts, in which equate to an ADV of 17,226 EFA option contracts (as that is 29 times the size of 594). EFA options, which are more actively traded and held than MXEA options, are currently subject to a position limit of 500,000 options contracts despite their much higher ADV of approximately 155,900 options contracts.

FXI tracks the performance of the FTSE China 50 Index, which is composed of the 50 largest Chinese stocks.¹⁵ FXI shares and options have also experienced increased liquidity since 2017, as ADV has grown from approximately 15.1 million shares in 2017 to 26.1 million through 2019, as well as approximately 71,900 options contracts in 2017 to 196,600 through 2019. Although there are currently no options on the FTSE China 50 Index listed for trading, the components of the FTSE China 50 Index, which can be used

¹³ See note 8. Cboe is proposing to raise the position limit on certain indexes. FINRA incorporates by reference the exchange position limits on indexes in FINRA Rule 2360(b)(3)(B) and accordingly does not need to propose any corresponding FINRA rule change.

¹⁴ See note 8. The values were presented by Cboe in their initial filing, which was approved by the Commission.

¹⁵ See iShares China Large-Cap ETF, available at <https://www.ishares.com/us/products/239536/ishares-china-largecap-etf> (February 10, 2020).

to create a basket of stocks that equate to the FXI ETF, currently have a market capitalization of approximately \$28 trillion and FXI has a market capitalization of \$4.8 billion (as indicated above), which are both large enough to absorb potential price movements caused by a large trade in FXI.

XLF invests in a wide array of financial service firms with diversified business lines ranging from investment management to commercial and investment banking. It generally corresponds to the price and yield performance of publicly traded equity securities of companies in the SPDR Financial Select Sector Index.¹⁶ XLF experiences ADV in shares and in exchange-traded options (48.8 million shares and 102,100 options contracts) that is significantly greater than the ADV in shares and options for EWZ (26.7 million shares and 186,500 options contracts), TLT (9.6 million shares and 95,200 options contracts), and EWJ (7.2 million shares and 5,700 options contracts), each of which already have a position limit of 500,000 contracts – the proposed position limit for XLF options. Although there are no options on the SPDR Financial Select Sector Index listed for trading, the components of the index, which can be used to create a basket of stocks that equate to the XLF ETF, currently have a market capitalization of \$3.8 trillion (indicated above). Additionally, XLF has a market capitalization of \$24.6 billion. Both of these are large enough to absorb potential price movements caused by a large trade in XLF.

Finally, HYG attempts to track the investment results of Markit iBoxx USD Liquid High Yield Index, which is composed of U.S. dollar-denominated, high-yield

¹⁶ See Select Sector SPDR ETFs, XLF, available at <http://www.sectorspdr.com/sectorspdr/sector/xlf> (January 15, 2020).

corporate bonds and is one of the most widely used high-yield bond ETFs.¹⁷ HYG experiences significantly higher ADV in shares and exchange-traded options (20 million shares and 193,700 options contracts) than both TLT (9.6 million shares and 95,200 options contracts), and EWJ (7.2 million shares and 5,700 options contracts), which are currently subject to a position limit of 500,000 options contracts – the proposed limit for options on HYG. While HYG does not have an index option analogue listed for trading, FINRA agrees with Cboe’s belief that HYG’s market capitalization of \$19.1 billion, and of \$906.4 billion in component securities, is adequate to absorb a potential price movement that may be caused by large trades in HYG.

FINRA believes that increasing the position limits for conventional options subject to the proposed rule change would lead to a more liquid and competitive market for these options, which will benefit customers interested in these products.

Creation and Redemption for ETFs

FINRA believes that the creation and redemption process for ETFs will lessen the potential for manipulative activity with options on the Underlying ETFs. When an ETF provider wants to create more shares, it looks to an Authorized Participant (generally a market maker or other large financial institution) to acquire the securities the ETF is to hold. For instance, when an ETF is designed to track the performance of an index, the Authorized Participant can purchase all the constituent securities in the exact same weight as the index, then deliver those shares to the ETF provider. In exchange, the ETF provider gives the Authorized Participant a block of equally valued ETF shares, on a one-

¹⁷ See iShares iBoxx \$ High Yield Corporate Bond ETF, available at <https://www.ishares.com/us/products/239565/ishares-iboxx-high-yield-corporatebond-etf> (January 15, 2020).

for-one fair value basis. The price is based on the net asset value, not the market value at which the ETF is trading. The creation of new ETF units can be conducted during an entire trading day, and is not subject to position limits. This process works in reverse where the ETF provider seeks to decrease the number of shares that are available to trade. The creation and redemption process, therefore, creates a direct link to the underlying components of the ETF, and serves to mitigate potential price impact of the ETF shares that might otherwise result from increased position limits for the ETF options.

FINRA understands that the ETF creation and redemption process seeks to keep an ETF's share price trading in line with the ETF's underlying net asset value. Because an ETF trades like a stock, its share price will fluctuate during the trading day, due to simple supply and demand. If demand to buy an ETF is high, for instance, the ETF's share price might rise above the value of its underlying securities. When this happens, the Authorized Participant believes the ETF may now be overpriced, so it may buy shares of the component securities and then sell ETF shares in the open market (i.e. creations). This may drive the ETF's share price back toward the underlying net asset value. Likewise, if the ETF share price starts trading at a discount to the securities it holds, the Authorized Participant can buy shares of the ETF and redeem them for the underlying securities (i.e. redemptions). Buying undervalued ETF shares may drive the share price of the ETF back toward fair value. This arbitrage process helps to keep an ETF's share price in line with the value of its underlying portfolio.

Surveillance and Reporting

FINRA believes that the increased position limits provisions are appropriate in light of the existing surveillance procedures and reporting requirements at FINRA,¹⁸ the options exchanges, and at the several clearing firms, which are capable of properly identifying unusual or illegal trading activity. These procedures use daily monitoring of market movements by automated surveillance techniques to identify unusual activity in both options and underlying stocks.¹⁹

In addition, large stock holdings must be disclosed to the Commission by way of Schedules 13D or 13G.²⁰ Options positions are part of any reportable positions and cannot legally be hidden. Moreover, the previously noted Rule 2360(b)(5) requirement that members must file reports with FINRA for any customer that held aggregate large long or short positions of any single class for the previous day will continue to serve as an important part of FINRA's surveillance efforts.

Finally, FINRA believes that the current financial requirements imposed by FINRA and by the Commission adequately address financial responsibility concerns that a member or its customer will maintain an inordinately large unhedged position in any option with a higher position limit. Current margin and risk-based haircut methodologies serve to limit the size of positions maintained by any one account by increasing the margin or capital that a member must maintain for a large position. Under Rule

¹⁸ See Rule 2360(b)(5) for the options reporting requirements.

¹⁹ These procedures have been effective for the surveillance of options trading and will continue to be employed.

²⁰ 17 CFR 240.13d-1.

4210(f)(8)(A), FINRA also may impose a higher margin requirement upon a member when FINRA determines a higher requirement is warranted. In addition, the Commission's net capital rule²¹ imposes a capital charge on members to the extent of any margin deficiency resulting from the higher margin requirement.

FINRA has filed the proposed rule change for immediate effectiveness and has requested that the SEC waive the requirement that the proposed rule change not become operative for 30 days after the date of the filing, so FINRA can implement the proposed rule change immediately.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,²² which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change promotes consistent regulation by harmonizing position limits with those of the other self-regulatory organizations. FINRA further believes that increasing the position limit on conventional options promotes consistent regulation by harmonizing the position limit with its standardized counterpart. In addition, FINRA believes the proposed rule change will be beneficial to large market makers and institutions (which generally have the greatest ability to provide liquidity and depth in products that may be subject to higher position limits as has been

²¹ 17 CFR 240.15c3-1.

²² 15 U.S.C. 78q-3(b)(6).

the case with recently approved increased position limits),²³ as well as retail traders and public customers, by providing them with a more effective trading and hedging vehicle.

In addition, FINRA believes that the structure of the Underlying ETFs, the considerable market capitalization of the funds, underlying component securities, and the liquidity of the markets for the applicable options and underlying component securities will mitigate concerns regarding potential manipulation of the products or disruption of the underlying markets upon increasing the relevant position limits. As a general principle, increases in market capitalizations, active trading volume, and deep liquidity of securities tend to deter manipulation or disruption. This general principle applies to the recently observed increased levels of market capitalization, trading volume, and liquidity in shares of the Underlying ETFs, and the components of the Underlying ETFs (as described above). FINRA does not believe that the options markets or underlying markets would become susceptible to manipulation or disruption as a result of the proposed position limit increases.

Increased position limits for select actively traded options, such as those proposed herein, are not novel and have been previously approved by the Commission. For example, a position limit of 1,800,000 contracts on options on SPY has been established.²⁴ Additionally, the Commission has approved similar proposed rule changes

²³ See note 8.

²⁴ See Securities Exchange Act Release No. 83349 (May 30, 2018), 83 FR 26123 (June 5, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-MIAX-2018-11). See also Securities Exchange Act Release No. 83412 (June 12, 2018), 83 FR 28298 (June 18, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-PHLX-2018-44); Securities Exchange Act Release No. 83414 (June 12, 2018), 83 FR 28296 (June 18, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-BOX-2018-22); Securities Exchange Act

by the options exchanges to increase position and exercise limits for options on highly liquid, actively traded ETFs.²⁵ Furthermore, the proposed position limits on EFA and FXI are consistent with existing position limits for options on IWM and EEM, and the proposed limits for options on XLF and HYG are consistent with current position limits for options on EWZ, TLT and EWJ.

FINRA's existing surveillance and reporting safeguards are designed to deter and detect possible manipulative behavior that might arise from changing position and exercise limits.

Release No. 83415 (June 12, 2018), 83 FR 28274 (June 18, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-CBOE-2018-042); Securities Exchange Act Release No. 83413 (June 12, 2018), 83 FR 28277 (June 18, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-NYSEArca-2018-44) and Securities Exchange Act Release No. 83417 (June 12, 2018), 83 FR 28279 (June 18, 2018) (Notice of Filing and Immediate Effectiveness of File No. SR-NYSEAMER-2018-26).

²⁵ See note 6. See also Securities Exchange Act Release No. 68086 (October 23, 2012), 77 FR 65600 (October 29, 2012) (Order Approving File No. SR-CBOE-2012-66); Securities Exchange Act Release No. 68478 (December 19, 2012), 77 FR 76132 (December 26, 2012) (Notice of Filing and Immediate Effectiveness of File No. SR-BOX-2012-23); Securities Exchange Act Release No. 68398 (December 11, 2012), 77 FR 74700 (December 17, 2012) (Notice of Filing and Immediate Effectiveness of File No. SR-ISE-2012-93); Securities Exchange Act Release No. 68293 (November 27, 2012), 77 FR 71644 (December 3, 2012) (Notice of Filing and Immediate Effectiveness of File No. SR-Phlx-2012-132); Securities Exchange Act Release No. 68358 (December 5, 2012), 77 FR 73708 (December 11, 2012) (Notice of Filing and Immediate Effectiveness of File No. SR-NYSE MKT-2012-71); Securities Exchange Act Release No. 68359 (December 5, 2012), 77 FR 73716 (December 11, 2012) (Notice of Filing and Immediate Effectiveness of File No. SR-NYSEArca-2012-132) and Securities Exchange Act Release No. 69457 (April 25, 2013), 78 FR 25502 (May 1, 2013) (Notice of Filing and Immediate Effectiveness of File No. SR-MIAX-2013-17).

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 Act.

Economic Impact Analysis

FINRA has undertaken an economic impact assessment, as set forth below, to analyze the potential economic impacts, including anticipated costs, benefits, and distributional and competitive effects transfers of wealth, relative to the current baseline, and the alternatives FINRA considered in assessing how to best meet its regulatory objectives.

Regulatory Objective

FINRA is proposing to amend Rule 2360 to harmonize FINRA's position limits for conventional options with the position limit for standardized options.²⁶

Economic Baseline

Per FINRA Rule 2360(b)(3)(A)(iii) conventional equity options are subject to a basic position limit of 25,000 contracts or higher for conventional option contracts on securities that underlie exchange-traded options qualifying for a higher tier as determined by option exchange rules. The existing position limits for conventional options on ETFs are: 1,800,000 contracts for SPY, 500,000 contracts for EFA or FXI and 250,000 contracts for HYG or XLF. Cboe has recently increased position limit options on these ETFs.

²⁶ See note 8.

Economic Impact

Benefits

As noted above, the proposed rule change would amend Rule 2360 to harmonize FINRA's position limits for conventional options with the position limits for standardized options.²⁷ If the existing position limits for conventional equity options on select ETFs constrains trading in these ETFs, then investors may be able to better manage risk and trade on information when the position limit is relaxed. In general, the improvement in risk management and informational efficiency may increase more when position limits are increased. FINRA acknowledges, however, that the conventional options on these ETFs, the ETFs themselves, and the securities underlying these ETFs are liquid, so improvements in informational efficiency may be relatively small.

For investors that trade conventional equity options, there is likely to be a natural size for an executed order that minimizes fixed and variable transaction costs, including but not limited to, the bid-ask spread, price impact, and transaction fees. If the existing position limits for conventional equity options on select ETFs constrains the order size such that fixed and variable transaction costs are higher than optimal, then investors may benefit if the new position limit is no less than the natural size. In such an event, the cost to hedge an ETF would decline, thereby making it less costly to manage downside risk.

In addition, if the existing position limits serve as a constraint, then an increase in the position limits for conventional options on select ETFs could permit investors to more easily find a counterparty. If the number of counterparties increases, then the cost of

²⁷ See note 8.

hedging should decline as the half-spread narrows, thereby making it less expensive to manage downside risk.

The extent of the constraint imposed by the current limit on conventional options is related to the ability of an investor to achieve similar economic exposure through other means. If there are other securities, such as an option on a closely related index, that exist and provide similar economic exposure less expensively, then the value of lessening the position limits on conventional options on ETFs is lower.

Members may rely on information and data feeds from the Options Clearing Corporation to assist in their monitoring position limits. Because position limits on the standardized and conventional side have traditionally been consistent, members have relied on this feed for both standardized and conventional options. If the position limits between standardized and conventional options are conformed, then the cost from monitoring position limits should decline for member firms. Having the same position limits on standardized and conventional options, reduces the potential for excess loss that may be incurred when different limits are applied to the standardized versus conventional options on the same ETF. The economic loss may arise from building and maintaining trading and compliance systems to support the different regimes. Furthermore, the harmonization of position limits on standardized and conventional options eliminates the potential risk and cost arising from regulatory arbitrage.

Costs

The proposed rule change may impose limited operational cost on member firms that trade conventional options on ETFs, as these same firms would need to revise position limits that are used in trading systems. However, the proposed rule change

should not impose additional costs, because it is difficult to disrupt or manipulate the underlying market, create an incentive to disrupt or manipulate the underlying market for the purpose of profiting from the options position, or disrupt or manipulate the options market for conventional options on ETFs affected by this proposed rule. ETFs that underlie options subject to the proposed rule change are highly liquid and are based on a broad set of highly liquid securities, which makes the market difficult to manipulate or disrupt. In fact, options on certain broad-based security indexes have no position limits. Furthermore, the creation and redemption process for these ETFs reduces the potential for disruptive or manipulative activity. New ETF units may be created at any time during the trading day and are not subject to position limits. Consequently, there is a direct link between the underlying components of the ETF and the ETF, which keeps the ETF's share prices trading in line with the ETF's underlying net asset value.

Alternatives

No further alternatives are under consideration.

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

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) of the Act²⁸ and Rule 19b-4(f)(6) thereunder.²⁹

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.

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-FINRA-2020-021 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.

²⁸ 15 U.S.C. 78s(b)(3)(A).

²⁹ 17 CFR 240.19b-4(f)(6).

All submissions should refer to File Number SR-FINRA-2020-021. 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. 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-FINRA-2020-021 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.³⁰

Jill M. Peterson
Assistant Secretary

³⁰ 17 CFR 200.30-3(a)(12).