

OTC Options Reporting

FINRA Requests Comment on Proposed Trade Reporting Requirements for Over-The-Counter Options Transactions

Comment Period Expires: September 20, 2022

Summary

FINRA is soliciting comment on a proposal to establish a new trade reporting requirement for transactions in over-the-counter options on securities with terms that are identical or substantially similar to listed options. FINRA is proposing to require firms to report this information to FINRA on a daily basis (end-of-day) for regulatory purposes only.

Questions regarding this *Notice* should be directed to:

- ▶ Danny Mileto, Vice President, Market Regulation, at (212) 457-5323 or danny.mileto@finra.org; or
- ▶ Adam Kezsbom, Associate General Counsel, Office of General Counsel, at (202) 728-8364 or adam.kezsbom@finra.org.

Questions regarding the Economic Impact Assessment in this *Notice* should be directed to Matthew Peppe, Economist, Office of the Chief Economist, at (202) 222-8841 or matthew.peppe@finra.org.

Action Requested

FINRA encourages all interested parties to comment on this proposal. Comments must be received by September 20, 2022.

Comments must be submitted through one of the following methods:

- ▶ Online using FINRA's comment form for this *Notice*;
- ▶ Emailing comments to pubcom@finra.org; or
- ▶ Mailing comments in hard copy to:

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

June 22, 2022

Notice Type

- ▶ Request for Comment

Suggested Routing

- ▶ Compliance
- ▶ Institutional
- ▶ Legal
- ▶ Operations
- ▶ Options
- ▶ Risk
- ▶ Systems
- ▶ Technology
- ▶ Trading
- ▶ Training

Key Topics

- ▶ Calls
- ▶ Index Options
- ▶ Options
- ▶ Options Reporting
- ▶ Over-the-Counter Options
- ▶ Puts
- ▶ Transaction Reporting

Referenced Rules & Notices

- ▶ FINRA Rule 2360
- ▶ Notice to Members 07-03
- ▶ Regulatory Notice 16-17

To help FINRA process and review comments more efficiently, persons should use only one method to comment on the proposal.

Important Notes: Comments received in response to *Regulatory Notices* will be made available to the public on the FINRA website. In general, comments will be posted as they are received.¹ Before becoming effective, the proposed rule change must be filed with the SEC pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA or Exchange Act).²

Background and Discussion

As a general matter, firms may trade “listed options” (*i.e.*, “standardized options”) through a registered options exchange³ or firms may trade “over-the-counter options” (*i.e.*, OTC or “conventional” options), which are customized, bilateral options transaction agreed to and traded directly by the parties to the option contract.⁴ A firm may choose to trade an OTC option even where the terms of the OTC option are identical or substantially similar to a listed option. When a firm trades an OTC option, the transaction is not generally cleared by a central clearing agency, nor is the transaction required to be reported to FINRA, the SEC, an exchange or the Consolidated Audit Trail.⁵ Thus, there is limited information available to regulators or the public regarding these transactions.

Based on FINRA’s analysis, a significant amount of firm trading occurs in OTC options with terms that are substantially similar to listed options. While FINRA does not currently have access to a data source specifically for transactions in OTC options, firms currently are required to report OTC and listed large options positions to FINRA pursuant to Rule 2360 (Options) (the large options positions reporting (LOPR) or LOPR rule). Using LOPR data, FINRA is able to infer the net notional amount of OTC options trading that occurred on a given day. Based on these calculations, FINRA believes that the notional amount of OTC options trading activity is significant. However, LOPR information is limited in many respects and does not identify a number of critical data elements that would be helpful for surveillance purposes, such as the price and time of individual transactions.⁶

Proposed Amendments

To address this regulatory gap, FINRA proposes to require firms to report transactions in an OTC option⁷ that is a put⁸ or call⁹ on a listed underlying security(ies) (including an option on an individual underlying security or an option on a basket of securities that meets the definition of a “conventional index option”¹⁰), including transactions executed by the firm on either a principal or agency basis. This proposal is limited to options with terms that are identical or substantially similar to listed options, including FLEX options.¹¹ Specifically, firms would be required to report a trade in an OTC option where:

- I. there is a listed option on the same underlying security (e.g., a single stock or an index),¹² or the OTC option is overlying one or more U.S.-listed securities;¹³
- II. the option type is a put, a call, or an option type related to a put or a call;¹⁴ and
- III. where the exercise style is one of the following: American, European, Asian, Cliquet or Binary.¹⁵

For OTC options that meet the above criteria, FINRA proposes to require firms to report the data elements specified in Appendix A.¹⁶

The proposal would require firms to submit OTC option trades in batch form to FINRA on a daily basis through fileX, FINRA's data collection platform. Firms would be permitted to correct previously reported information up to five days following trade date (T+5), consistent with the correction timeframe in the LOPR system. Firms would be required to report both the initial trade as well as any amendments to the initial contract that change any of the terms previously reported. Firms would also be required to report when the option is exercised. Firms would not, however, be required to report actions occurring pursuant to the terms of the contract (e.g., scheduled termination).

FINRA is not proposing to adopt a trade reporting fee or to publicly disseminate the collected OTC options transaction data at this time. Once FINRA obtains more experience with the data, FINRA may consider disaggregated public dissemination of all or part of the data, automation of the trade reporting process, or the imposition of fees, all of which would be subject to filing with the SEC.

Economic Impact Assessment

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, relative to the current baseline, and the alternatives FINRA considered in assessing how to best meet its regulatory objectives. FINRA invites comments on all aspects of this assessment and requests that commenters provide empirical data or other factual support wherever possible.

Regulatory Need

The proposed OTC options trade reporting requirements would improve FINRA's surveillance of the securities markets as well as cross-product and cross-market surveillance. For example, the data would allow FINRA to identify potentially manipulative behavior that can only be observed to a limited extent today relying on LOPR data. A regulatory audit trail for transactions in OTC options that have terms that are identical or substantially similar to listed options would allow FINRA to better understand and review firm and customer trading activities, the relationship between transactions in OTC options and listed options (as well as other instruments) and provide information necessary to oversee for compliance with best execution and other FINRA rules.

Economic Baseline

As discussed above, firms currently do not report OTC options trades to FINRA but are required to report to the LOPR system large end-of-day options positions, including OTC options positions. For OTC options, a firm must also report an account's intraday positions. Firms submit position information to the LOPR system by the close of business on the next day.¹⁷

While LOPR data is useful, the proposed reporting requirement would improve FINRA's audit trail by providing additional insight at the transaction level. For example, two particularly important fields not available in the LOPR data are the time of the transaction that resulted in each position change and the option premium. Additionally, only positions of 200 or more contracts are reportable to the LOPR system, so the data does not reflect changes that are below this threshold.

Using LOPR data from January 2021 to June 2021, FINRA has conducted an analysis to study the extent and scope of OTC options trading by firms. This analysis infers trading activity from reported position changes. However, as discussed above, the LOPR system does not collect information on positions of less than 200 contracts; therefore, this analysis would not include smaller positions. In addition, and as noted above, this proposal is intended to capture only specified OTC options (*i.e.*, those with terms that are identical or substantially similar to listed options). Since the scope of the LOPR data is broader in this regard, the analysis below will include options that would not be reportable under the proposal.

FINRA estimates that 24 firms participate in OTC options trading based on the January 2021 to June 2021 LOPR data sample.¹⁸ Of these firms, 20 are large, three are mid-size and one is small.¹⁹ However, the smallest firm has over 100 registered representatives.

Table 1. Firms Reporting Large OTC Option Positions

Firm Size	Number of Firms (January 2021 to June 2021)	Percent of Total Firms
Large (>= 500 Registered Representatives)	20	83%
Mid-Size (151-499 Registered Representatives)	3	13%
Small (1-150 Registered Representatives)	1	4%

Using LOPR data, FINRA estimates that approximately 7,420 transactions in OTC options per day may occur across all firms.²⁰ The associated dollar volume cannot be quantified because the LOPR system lacks information on options premiums. The top five firms, all of which are large firms, are estimated to account for approximately 88 percent of trades.

Potential Economic Impacts

FINRA believes information on OTC options transactions will improve its oversight of the securities markets. The transaction information proposed to be collected will assist FINRA in identifying suspicious activity, including potential instances of insider trading, front running, pre-arranged trading, and market manipulation in the equity and options markets. For example, FINRA has identified potentially violative conduct involving OTC options discovered from complaints, investigations or through other means, that is not identifiable in LOPR data, but that could be more readily detected using the type of transaction data proposed to be collected. The information proposed to be collected would also potentially improve cross-product surveillance by creating a more complete audit trail of trading in OTC options and the underlying equity security. The information proposed to be collected also will streamline FINRA's investigative process and improve its efficiency. Currently, if FINRA identifies suspicious activity based on LOPR data or other sources, any necessary transaction information must be requested from the firms involved. Thus, the proposal would improve efficiency for FINRA, and firms may benefit from the reduced labor required to respond to such requests. FINRA also notes that, because firms are currently not required to report OTC options transactions, there exists the potential for regulatory arbitrage between the OTC options and listed options markets. In addition, firms also are currently only required to report listed options trades to the Consolidated Audit Trail.

Firms that trade OTC options would incur upfront costs associated with making systems changes required to report OTC option transactions and ongoing fixed costs for maintaining their system. Firms would also incur ongoing labor costs to the extent that reporting cannot be automated. These costs could be borne by investors if passed along in the form of higher transaction costs.

Firms currently have systems in place to generate LOPR reports for OTC option positions. To the extent that existing systems may be modified to facilitate the proposed reporting requirements, costs may be relatively lower. However, we note that the proposed transaction reporting requirements and LOPR requirements differ in several ways. For example, the LOPR fields differ in some regards from those proposed to be required under this proposal. Transaction reporting could thus require the use of a separate system or involve substantial costs to modify an existing system.

The cost of compliance may affect firms differently. Activity in the OTC options market is not evenly distributed. We estimate that, out of the 24 firms that report OTC options positions to the LOPR system, the bottom 19 firms account for only 12 percent of trades. If the fixed cost of establishing and maintaining a reporting system is substantial, it may be relatively more burdensome for firms with less total activity in the OTC options market and may potentially place them at a competitive disadvantage.

The costs of the proposed reporting requirement may depend on various factors, including the level of difficulty involved in determining whether a particular option is subject to transaction reporting, given that these transactions are typically negotiated individually. Such difficulty could also result in over- or under-reporting of certain types of options, which would reduce the regulatory utility of the data.

To the extent that market participants wish to avoid transaction reporting, they may shift their trading activity in three ways. First, market participants could potentially shift their trading from OTC options subject to the proposed transaction reporting requirement to more exotic OTC options that provide similar exposure but that would not be reportable under the proposed requirement. These shifts could reduce the number of transactions subject to reporting under the proposal and may also lead to higher costs as shifting to more exotic OTC options may result in less perfect hedging for customers seeking to gain a particular market exposure. Second, market participants could potentially shift activity to non-FINRA firms, such as banks, which could impact firms that trade OTC options by reducing their market activity.²¹ Finally, market participants could potentially shift their trading to similar listed options, if they are available and, in that case, the exchanges' reporting requirements for listed options would apply.

Alternatives Considered

No other alternatives beyond those discussed above were considered for the proposed amendments.

Request for Comment

FINRA requests comment on all aspects of the proposal. FINRA requests that commenters provide empirical data or other factual support for their comments wherever possible. In addition to general comments, FINRA specifically requests comment on the following questions:

1. Why do firms trade OTC options where similar listed options are available? What considerations drive this determination?
2. Is there a substantial amount of firm activity in smaller sized OTC options contracts that are not required to be reported to the LOPR system? Are there firms that trade OTC options, but never trade positions large enough to trigger LOPR obligations?

3. FINRA is proposing that firms would initially only be required to report transactions in OTC options with terms that are identical or substantially similar to listed options, including FLEX options, as explained above. Do commenters agree with this proposed scope? Please explain.
4. Appendix A provides the fields and descriptions being contemplated under the proposal. Do commenters agree with the proposed fields? Why or why not? Please describe any challenges associated with the proposed fields.
5. Are there any fields that should not be included? Is there any information that was not included in Appendix A that should be collected? Please be specific.
6. What costs would be associated with the proposed OTC options reporting requirements? Please be specific.
 - a. What costs would be incurred by firms in connection with reporting the specified information?
 - b. What operational or other challenges would be associated with implementing the proposal?
7. How much time would firms need to implement necessary technological changes to comply with the proposed end-of-day reporting requirement? Do firms currently have systems in place that could be leveraged to assist in collecting and reporting the required information?
8. FINRA is proposing that firms be required to report trades at the end of the trade day with corrections permitted through T+5. Is this a feasible timeline for reporting OTC options transactions and corrections to FINRA? Why or why not?
9. FINRA is proposing that firms be required to report when OTC option trades are exercised. Do firms anticipate any challenges with respect to this aspect of the proposal? Please explain.
10. FINRA is proposing that firms would initially be required to submit OTC option trades in batch form on a daily basis through fileX, FINRA's data collection platform. Do firms anticipate any challenges with this reporting method? Please be specific.
11. How will the proposed reporting requirements impact market participants' behavior in the OTC options market? Might market participants alter their behavior due to the proposed requirements? If so, how?
12. FINRA is proposing that the information gathered would be used solely for regulatory purposes at this time and would not be publicly disseminated on a disaggregated basis. FINRA may explore providing public transparency once FINRA has gained experience with the data. FINRA is interested in views on whether firms, investors and other market participants would benefit from public transparency regarding OTC options transactions.

Attachment A

Data Elements

Field	Description
Record Type	New trade, correction or exercise
Order Received Time	Time that the BD receives the order from the customer
Execution Timestamp	The time and date of execution
Trade ID	A unique value provided by the member shared by all reportable OTC option components of a single contract
Underlying	Underlying on which the option is based
Option Strike Price	The level or price at which an option may be exercised ²²
Option Expiration Date	The last date the option holder may exercise the option
Option Type	Whether the option is a put or call
Exercise Style	How the option can be exercised (American, European, Asian, Cliquet, Binary)
Settlement Valuation Time	The time used to calculate the settlement price (<i>e.g.</i> , AM, PM, or a specific time)
Settlement Style	How the option is settled upon exercise— <i>i.e.</i> , whether physically or cash settled
Settlement Currency	The settlement currency type for cash settled options
Observation Day	The date of each month on which the closing price of the underlying index is observed for the purpose of calculating the exercise settlement value (only required for Asian and Cliquet options)
Capped Return	The capped return of the option contract is the maximum monthly return (only required for Cliquet options)
Creation Date	The creation date of a Cliquet option is the first observation date on which the subsequent performance is based (only required for Asian and Cliquet options)
Reporting Firm CRD	CRD of firm reporting the transactions
Buy Account Type	Account Type of Buy Side ²³
Buy Account Number	Account Number of Buy Side
Buy Name	Full Name of Buy Side

Field	Description
Buy Address	Address of Buy Side
Sell Account Type	Account Type of Sell Side
Sell Account Number	Account Number of Sell Side
Sell Name	Full Name of Sell Side
Sell Address	Address of Sell Side
Option Premium	The cost of the option. This field is associated with the option currency field ²⁴
Option Currency	An indication of the type of currency of the option premium. The option currency may be reported in a commonly accepted code (e.g., the three-character alphabetic ISO 4217 currency code)
Size Type	Whether the contract is based on shares or currency
Trade Size	Numeric value, either contracts or monetary value, dependent on value supplied in Size Type. For exercise records, this would represent the net funds or shares delivered
Multiplier	Number of shares deliverable for each option contract or number of units (for index options)
Trade Currency	Required if Size Type is "currency." (e.g., the three-character alphabetic ISO 4217 currency code)
Deconstructed Flag (Y/N) ²⁵	If the trade is part of a deconstructed option contract

Endnote

1. Parties should submit in their comments only personally identifiable information, such as phone numbers and addresses, that they wish to make available publicly. FINRA, however, reserves the right to redact, remove or decline to post comments that are inappropriate for publication, such as vulgar, abusive or potentially fraudulent comment letters. FINRA also reserves the right to redact or edit personally identifiable information from comment submissions.
2. See SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Some proposed rule changes take effect immediately upon filing with the SEC. See SEA Section 19(b)(3) and SEA Rule 19b-4.
3. U.S. options exchanges include: BOX Exchange, LLC; Cboe Exchange, Inc.; Cboe BZX Exchange, Inc.; Cboe C2 Exchange, Inc.; Cboe EDGX Exchange, Inc.; MIAX Options Exchange; MIAX Emerald, LLC; MIAX Pearl, LLC; Nasdaq BX, Inc.; Nasdaq GEMX, LLC; Nasdaq ISE, LLC; Nasdaq MRX, LLC; Nasdaq Options Market; Nasdaq PHLX, LLC; NYSE American LLC; NYSE Arca, Inc.
4. As used throughout this notice, “OTC options” are options that meet the definition of “conventional option” under FINRA Rule 2360(a)(9). The term “conventional option” means: (A) any option contract not issued, or subject to issuance, by The Options Clearing Corporation (OCC); or (B) an OCC Cleared OTC Option. The term “OCC Cleared OTC Option” means any put, call, straddle or other option or privilege that meets the definition of an “option” under Rule 2360(a)(21), and is cleared by the OCC, is entered into other than on or through the facilities of a national securities exchange and is entered into exclusively by persons who are “eligible contract participants” as defined in the Exchange Act.
5. The rules of both FINRA and the national securities exchanges provide for position limits. Position limits are intended to prevent firms establishing 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. See e.g., FINRA Rule 2360 (b)(3)(A)(i).
6. Concerns around this potential regulatory gap have been previously raised, including a recommendation that OTC options transactions be reported to improve oversight in this area. See generally [letter](#) from Edward T. Tilly, Chief Executive Officer, CBOE, to Stephen I. Luparello, Director, Division of Trading and Markets, SEC, dated October 2, 2014.
7. See FINRA Rule 2360 (a)(21). The term “option” means any put, call, straddle, or other option or privilege, which is a “security” as defined in Section 2(1) of the Securities Act, as amended, but shall not include any tender offer, registered warrant, right, convertible security or any other option in respect to which the writer (seller) is the issuer of the security which may be purchased or sold upon the exercise of the option.
8. See FINRA Rule 2360(a)(28). The term “put” means an option contract under which the holder of the option has the right, in accordance with the terms of the option, to sell the number of units of the underlying security or deliver a dollar equivalent of the underlying index covered by the option contract.

9. See FINRA Rule 2360(a)(2). The term “call” means an option contract under which the holder of the option has the right, in accordance with the terms of the option, to purchase the number of units of the underlying security or to receive a dollar equivalent of the underlying index covered by the option contract.
10. Generally speaking, a “conventional index option” is any options contract not issued, or subject to issuance, by the OCC, or an OCC Cleared OTC Option, that, as of the trade date, overlies a basket or index of securities that: (a) underlies a standardized index option; or (b) satisfies criteria specified in FINRA Rule 2360(a)(8)(B) regarding the composition of the basket. If the underlying basket does meet the criteria specified in FINRA Rule 2360(a)(8)(B), then the option would not be required to be reported to LOPR and would not be required to be reported under the proposal. See FINRA Rule 2360(a)(8).
11. Flexible listed options, or “FLEX” options, are listed options that allow both the writer and purchaser to negotiate specific terms. Terms that are negotiable include: the exercise style, strike price, and expiration date, as well as other features and benefits.
12. The proposed transaction reporting requirement would be similar to the LOPR requirement for conventional index options. See Rule 2360(b)(5)(A)(i)a., which provides that firms must report positions in conventional index options that are based on an index that underlies, or is substantially similar to an index that underlies, a standardized index option.
13. The proposed scope would include instances in which there are listed options on the same underlying security as well as where there is no corresponding listed option. For example, there may be a period of up to a few days between the initial listing of a new issue security and the availability of listed options on such security; however, OTC options can be traded on the newly listed underlying security in that period. In these instances, OTC options on the recent IPO shares would be included in the scope of the proposed transaction reporting requirement because the underlying is a listed security. The proposed requirement is not intended to apply to exotic options, including options where the underlying security on which the option is valued is not explicitly known at the time of the transaction. For example, the proposed requirement would not apply to knock-in or knock-out options (options that come into existence or cease to exist when the price of the underlying asset reaches or breaches a specific price level) or best of / worst of options (options where the investor receives the gain on the best or worst performing stock among a predefined number of stocks).
14. The proposed requirement would apply to an OTC option where the option type is a put, a call, or an option type related to a put or a call (as it concerns an underlying risk component of an option contract). For example, a “Delta One” product, which is a product that combines the risk profile of both a put and a call, would be required to be deconstructed and separately reported as a put and a call transaction.
15. “Exercise style” refers to how and when the option can be exercised. FINRA is proposing to limit the reporting requirement to American, European, Asian, Cliquet and Binary styled options. American options may be exercised at any time during the life of the option. European options may only be exercised at expiration of the option. Asian and Cliquet options are European options where the exercise settlement value is a calculation based on the terms of the

- option. Binary options are European options that offer a fixed return based on whether the settlement value finishes above the strike price at expiration.
16. See Appendix A – Data Elements. Once FINRA has gained experience with receiving reports in these types of OTC options, FINRA may consider expanding the reporting requirement to include additional categories of OTC options, including exotic options.
 17. OCC hosts the LOPR system and collects and disseminates all LOPR data for the U.S. options exchanges and FINRA.
 18. FINRA believes, based on our understanding of the OTC options market, that it is unlikely that many firms trade OTC options but never trade positions large enough to trigger LOPR obligations.
 19. For definitions of firm sizes, see Table 1; see also [FINRA 2021 Industry Snapshot](#).
 20. FINRA identified 1,825,320 new positions or modifications to previous positions in LOPR between January and June 2021. FINRA divided this number by 2 to estimate 912,660 trades during this time period because firms generally report both the long and short positions arising from an OTC option contract. The sample period included 123 trading days, which corresponds to 7,420 trades per day. In addition to the limitations of the LOPR data discussed above, this estimate is inexact because firms may report only the short or long position in some circumstances.
 21. The definitions of “broker” and “dealer” under the Exchange Act exclude banks effecting transactions in, or buying and selling, identified banking products as defined in Section 206 of the Gramm-Leach-Bliley Act (GLBA). See SEA Sections 3(a)(4)(B)(ix) and (5)(C)(iv). Under GLBA Section 206(a)(6), an “identified banking product” includes any swap agreement, including credit and equity swaps, except for an equity swap sold directly to any person other than a qualified investor. GLBA Section 206(b) defines a “swap agreement” to include, among other things, an option based on one or more securities. Therefore, banks are permitted to engage in OTC options with qualified investors without becoming broker-dealers.
 22. The strike price that the firm should report is the contract strike price for the option, irrespective of whether the option is reported as a single contract or is a deconstructed option (as noted by the Deconstructed Flag field below).
 23. The “Buy Account Type” and “Sell Account Type” fields will be consistent with LOPR reporting (e.g., customer, firm) and will provide FINRA with insight into whether the firm is acting as principal or agent.
 24. The options premium that the firm should report is the total contract price for the option, irrespective of whether the option is reported as a single contract or is a deconstructed option (as noted by the Deconstructed Flag field described below).
 25. FINRA intends to take an approach consistent with the LOPR requirement to deconstruct options on multiple underlying securities that do not meet the definition of “conventional index option” in FINRA Rule 2360(a)(8). For example, a firm would be required to deconstruct an OTC option overlying a basket of ABC and XYZ by separately reporting its component options and would report an OTC ABC option transaction and an OTC XYZ option transaction. See [Notice to Members 07-03](#) (January 2007) and [Regulatory Notice 16-17](#) (May 2016).