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Via email

pubcom@finra.org
Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

RE: Regulatory Notice 22-14: Proposed Amendments to FINRA Rule 3240 and Retrospective Rule Review Report Proposed Trade Reporting Requirements for Over-The-Counter Options Transactions

Dear Ms. Mitchell:

The University of Pittsburgh Securities Arbitration Clinic (the "Clinic") appreciates the opportunity to comment on the Financial Industry Regulatory Authority's ("FINRA") retrospective rule review on issues relating to the proposed amendments to the trade reporting requirements for over-the-counter ("OTC") options transactions. The Clinic, a University of Pittsburgh curricular offering, provides legal representation to investors who have limited resources, often advocating for people whose claims represent much of their life savings. The Clinic provides the following commentary on the proposed trade reporting requirements for Over-The-Counter Options Transactions.

Introduction

OTC options are non-standardized, custom options that are privately traded. This differs from the more prevalent options that are commonly traded on public markets. Regular options trading is highly regulated, and subject to FINRA reporting requirements. On the other hand, OTC options function more as a private contract between two parties. OTC options allow for two parties to customize the terms and use non-traditional securities to underlie the option. Due to the inherent customization of these options and the fact that the options are not traded on secondary markets, they are more likely to be traded by institutions than individual investors.[1] Although smaller investors are not typically trading OTC options, it is in their best interest to have market transparency so they have all of the pertinent information prior to making trades. Throughout this memo we have answered questions 1, 3, 11, and 12 from FINRA Regulatory Notice 22-14 ("the Notice").

1. Why do firms trade OTC options when similar options are available?

Firms choose to trade OTC options when they need an added degree of customization to what is available on public markets. OTC options are a type of derivative security that is secured by anything that is not available on US Securities Exchanges.[2] This can include: foreign companies, smaller domestic companies, or even other OTC options and OTC futures.[3] Firms are able to privately change terms with the other party to customize the options. Although this level of customization can be advantageous, it brings a heightened degree of risk. The underlying securities that these options derive from do not receive the same degree of regulation from FINRA and the US Securities markets. Furthermore, a regular option can be readily traded in a transaction that is standardized on the secondary markets, but conversely an OTC option is much more illiquid as the customization leads to the option being significantly more difficult to trade[4].

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[1] Samuel Becker, "What Are Over-the-Counter (OTC) Options? How do they work?", SoFi (2022). https://www.sofi.com/learn/content/otc-options/ (Last accessed September 18, 2022).
[2] *Id.*
[3] *Id.*
[4] *Id.*

Use of Options Transactions Data by Market Participants

Data on listed options transactions can be used by "experienced traders and investors" to glean "meaningful insights on the price movements of the underlying security."[5] This is done through different methodologies and tools to analyze data such as Put-Call Ratios (PCRs).[6] Various forms of PCR data can be obtained from listed option exchanges,[7] but PCR data regarding OTC options are not as readily available.[8] This information has bearing on questions 3, 11, and 12 of the Notice.

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?

It would be in the best interest of investors and other market participants to broaden the scope of which transactions are required to be reported beyond what has been suggested. Experts in securities law have expressed the desire that companies that register OTC securities should be required to disclose more information, in order to extend the protections provided to listed securities but the Securities Exchange Act of 1934 to OTC securities.[9] This has been suggested in order to expand the protections that investors and other market participants have when they purchase OTC securities, and to provide them with greater information that they can utilize when they plan their investment strategies.

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[5] Shobhit Seth, "Use Options Data To Predict Stock Market Direction," Investopedia (2022). https://www.investopedia.com/articles/investing/100115/use-options-data-predict-stock-market-direction.asp (Last Accessed September 18, 2022).

[6] *Id.*

[7] *Id.*

[8] *See* FINRA Notice 22-14.

[9] *See* A Securities Primary Law Sourcebook II (2022). https://plus.lexis.com/api/permalink/8db63ea3-6671-4e6e-b5af-1cef21fe0285/?context=1530671

However, further protections are not the only thing that can help investors, as having more information on OTC options transactions can help experienced investors analyze the price movements on their underlying transactions.[10] To provide investors with more information on OTC transactions, the scope of which OTC options transactions are required to be reported should be broadened in order to obtain information on OTC options that are not identical or substantially similar to listed options. Furthermore, once FINRA has gained more experience with the data, this information should be publicly disseminated in order to provide more than a limited benefit to experienced investors and other market participants as discussed below in our answer to Question 12.

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?

Experienced investors and other market participants that purchase OTC options may alter their behavior by analyzing any data that may be publicly disseminated by FINRA at a later date in order to evaluate their plans on future purchases of OTC options. This is discussed in greater detail below in our answer to Question 12. Whereas there is a continuous flow of information about market and trading activities in the exchange markets, comparable information concerning the OTC market is not available.[11] These proposed requirements would allow FINRA to collect much more information regarding over-the-counter trading. This additional surveillance would likely limit manipulative behavior that is not able to be observed with current reporting requirements.

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[10] *See supra* Shobhit (2022).

[11] Martin A. Rogoff, "Legal Regulation of the Over-The-Counter Market Manipulation: Critique and Proposal," 28 Maine L. Rev. 149 (1976). https://mainelaw.maine.edu/faculty/wp-content/uploads/sites/4/rogoff-mlr-28.pdf

12. FINRA is interested in views on whether firms, investors and other market participants would benefit from public transparency regarding OTC options transactions.

Public transparency of data on OTC options transactions would provide firms, investors, and other market participants with a limited benefit by allowing them to analyze such data alongside data on listed options transactions. As FINRA's proposal is only requiring firms to report OTC options transactions "that are identical or substantially similar to listed options," public transparency of such data may not provide a significant benefit to traders, investors, firms, and other market participants. However, such data may reinforce and aid in the analysis of data of listed options transactions that are substantially similar to OTC options transactions.

Conclusion

Firms will trade in OTC options even when similar options listed on exchanges are available due to the customizability of OTC options contracts. The Notice proposes requiring firms to report transactions in OTC options that are identical or substantially similar to options listed on exchanges. We agree with this decision, as it allows FINRA to collect information on OTC transactions and would likely limit manipulative behavior. However, we recommend broadening the scope of which OTC options transactions are required to be reported, and disseminating this data to the public once FINRA has analyzed the data. Doing so will likely help small investors by allowing experienced investors and other market participants to analyze the data on OTC options transactions alongside the data from listed options transactions in order to gain insight into the price movements of specific securities.

Thank you for this opportunity to comment on the proposed amendments to the trade reporting requirements for over-the-counter ("OTC") options transactions. It is important to our clinic at the University of Pittsburgh School of Law, as our clinic provides legal representation to investors with limited resources, often advocating for people whose claims represent much of their life savings. For the aforementioned reasons, we submit our comments on the proposed amendments and the above suggestions.

Respectfully Submitted,

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