September 20, 2022

VIA ELECTRONIC SUBMISSION

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

Re: Regulatory Notice 22-14; FINRA Requests Comment on Proposed Trade Reporting Requirements for Over-The-Counter Options Transactions

Dear Ms. Piorko Mitchell:

FINRA is requesting comment on its proposal to require firms to report transactions in over-the-counter ("OTC") options that are puts or calls, in batch form to FINRA on a daily basis through fileX.[1] As the creator of listed options, Cboe Global Markets, Inc. ("Cboe")[2] appreciates the opportunity to provide feedback on this topic.

OTC options are not listed or traded on an exchange. Transactions are negotiated privately between the parties to the trade. The terms are customized, and the process is opaque. These bilateral transactions typically are not centrally cleared, and counterparty credit risk is present. Because there is little transparency into these transactions, regulators have limited insight into this market which is vast.[3] Allowing institutional market participants to customize terms to suit a particular investment profile, makes OTC options appealing. To an increasingly significant extent, however, it appears that OTC options are being structured to materially mimic the terms of contracts that are available in the listed option market.

Listed options are highly regulated.[4] They are traded on a registered securities exchange and are centrally cleared by The Options Clearing Corporation ("OCC"). Listed options typically have standard contract

[1] Regulatory Notice 22-14 (FINRA Requests Comment on Proposed Trade Reporting Requirements for Over-The-Counter Options Transactions) (June 22, 2022).
[2] Cboe operates four U.S. listed options exchanges (Cboe Options, C2 Options, BZX Options, and EDGX Options), including the largest U.S. options exchange (Cboe Options).
[3] As of December 2021, the estimated global market for OTC options on equity securities had a notional value of $3.312 trillion with a gross market value of $377 billion. The estimated outstanding amount of OTC options on equity instruments in 2021 with one year or less until maturity was $2.104 trillion and the estimated amount outstanding with between one and five years until maturity was $1.062 trillion. (BIS Statistics Explorer as of March 8, 2022).
[4] Listed options are "standardized options" subject to Rule 9b-1 under the Securities Exchange Act of 1934.

terms, but FLEX options are a type of listed options that are able to have certain terms customized. Listed options trade in a public market with complete transparency around cost, order handling and execution.

Currently, listed options are treated differently than OTC options with respect to transaction reporting requirements. Unlike listed options, OTC option transactions are not required to be reported to FINRA (or any exchange), the SEC or the Consolidated Audit Trail.[5] As a result, FINRA is proposing to require firms to report to FINRA OTC option transactions (puts or calls) on listed underlying securities (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") that are identical or substantially similar to listed options, including FLEX options.[6] We agree with this approach.

OTC options can provide utility for certain investors in certain circumstances including when the desired contract terms are truly unique, and no comparable listed options are available. However, given the significant number of listed option series that are open for trading[7] and the availability of FLEX options, Cboe believes OTC options may be over-utilized – to the potential detriment of investors. As mentioned above, unlike listed options, OTC options are not centrally cleared and carry counterparty credit risk while also not being subject to the price discovery process and potential price improvement offered by on-exchange trading.

When bilateral, individually customized OTC options fill a void where there is not an identical or substantially similar standardized options contract available, their use may be appropriate, however, transparency and disclosure are warranted. The reporting requirements for OTC options being proposed by FINRA are modest and a sensible first step. They would facilitate review of aspects of OTC options trading including best execution considerations.

<u>Discussion</u>

a. *<u>Listed options have important features that identical or substantially similar OTC option contracts do not have.</u>*

The market for exchange-traded, standardized options is structured to encourage liquidity provision and order competition – all to the benefit of investors. For example, investors in listed options enjoy greater

[5] The rules of both exchanges and FINRA do provide for position limits for listed options (under the exchanges' and FINRA's rules) and for OTC options (under FINRA's rules), which are intended to prevent firms from 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.,* Cboe Options Rules 8.30 – 8.41 and FINRA Rule 2360 (b)(3). Also, various position reporting requirements apply. For instance, pursuant to exchange and FINRA rules members must report any account or accounts acting "In Concert" that hold over 200 contracts on either the long call/short put (bullish) or the short call/long put (bearish) side of the market via the Large Options Positions Report (LOPR). A member must report every subsequent change in the account's end of day (exchange traded & OTC, as applicable) or intraday (OTC) positions. *See, e.g.,* Cboe Options Rule 8.43 and FINRA Rule 2360.
[6] FLEX options are listed options that allow the user to customize key contract terms, such as exercise price, strike price, exercise style, and expiration date.
[7] As of August 25, 2022, there were 5,132 classes and 1,285,284 series listed on Cboe Options.

price discovery, price improvement and market liquidity than investors in similar OTC options. Additionally, market participants benefit generally from listed options transactions over OTC transactions due to trade reporting, exchange surveillance of trading and anti-manipulation rules. These benefits can be experienced by even more investors as the listed options space continues to innovate and provide increased flexibility and customization with respect to contract terms, such as Cboe Options' introduction of weekly expirations for SPX options, including Tuesday and Thursday expiries.

When options transactions are effected OTC, market participants do not receive the order interaction and full price discovery benefits of on-exchange trading.[8] Effecting options transactions OTC can also potentially negatively impact listed options customers as they are deprived of order interaction and liquidity that is diverted into OTC options. Effecting options transactions OTC when substantially similar or identical listed options are available can also result in market fragmentation and reduced price transparency.[9] These considerations warrant greater regulatory transparency as called for in the proposal.

b. *<u>The transparency measures being proposed for OTC options are a prudent first step and FINRA's definition of "substantially similar" is appropriate in order to avoid inconsistent interpretations for reporting.</u>*

Increased transparency is beneficial to investors and regulators and supports well-functioning and trusted markets. From a policy perspective, Cboe believes that any OTC options contract that is identical or substantially similar to a standardized listed option contract, should be required to have comparable transaction reporting requirements as listed options.

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. FINRA's proposal to require trade reporting for transactions in these OTC options, as defined in the proposal, makes sense as a first step. Ultimately, more, not less disclosure, is better for market participants and the entire options market stands to benefit from regulators having transparency into total existing risk via comparable trade reporting requirements for OTC and listed options.

c. *<u>OTC options make up a sizable portion of the total options market. Regulators should have better insight into the full size and risk profile of the options market via OTC options trade reporting requirements.</u>*

It is important for regulators to have insight into the OTC options market, at a minimum, underlying information, expiry date and size of each OTC options contract. Providing regulators with more visibility into the full size of the OTC options market will help allow for better market oversight and will ultimately serve investors well. Any increased transparency into this large segment of the options market should also be made available to all regulators to facilitate more rigorous regulation of the OTC options market.

[8] Yet, it is not uncommon for users of OTC options to query market-makers on an exchange, such as the Cboe Options trading floor, for pricing before taking a prospective listed options transaction over the counter (using pricing from the trading floor).

[9] While OTC options transactions rely on open exchange orders and last sale reporting to inform their OTC options pricing, customers on options exchanges do not currently receive similar information regarding OTC options to help inform their pricing. This information asymmetry can negatively impact investors.

In addition to this information being made available to regulators, investors would benefit from end-of-month summaries of the aggregated and anonymized OTC options trade data that could be publicly disseminated. Underlying information, expiry date and size data regarding the OTC options market would be helpful for investors to make better informed investment decisions.

Overall, trade reporting requirements for OTC options that are identical or substantially similar to listed options will provide important insight into this segment of the market and provide regulators with more transparency so they can better study the relationship between OTC options, listed options, and underlying securities and properly surveil for any regulatory issues raised by those OTC options transactions.

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Cboe appreciates the opportunity to share its views on the request for comment. Cboe welcomes the opportunity to discuss these comments further.

Sincerely,

Angelo Evangelou
Chief Policy Officer
Cboe Global Markets, Inc.