

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * 68	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4		File No.* SR - 2016 - * 127	Amendment No. (req. for Amendments *)
Filing by NASDAQ PHLX LLC 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 checked="" type="checkbox"/>	Section 19(b)(3)(A) * <input type="checkbox"/>
			Section 19(b)(3)(B) * <input type="checkbox"/>	
Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action * <input type="checkbox"/>	Date Expires * <input type="text"/>	Rule <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 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"/>			
<b>Description</b>				
Provide a brief description of the action (limit 250 characters, required when Initial is checked *).				
A proposal to amend Rules 1024, Conduct of Accounts for Options Trading; 1025, Supervision of Accounts; 1027, Discretionary Accounts; 1029, Delivery of Options Disclosure Documents; and 1049, Communications to Customers.				
<b>Contact Information</b>				
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 *	Carla	Last Name *	Behnfeldt	
Title *	Associate General Counsel			
E-mail *	carla.behnfeldt@nasdaq.com			
Telephone *	(215) 496-5208	Fax	<input type="text"/>	
<b>Signature</b>				
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	12/30/2016	Executive Vice President and General Counsel		
By	Edward S. Knight	<input type="text"/>		
(Name *)		edward.knight@nasdaq.com		
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) NASDAQ PHLX LLC (“Phlx” or “Exchange”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposal to amend Rules 1024, Conduct of Accounts for Options Trading; 1025, Supervision of Accounts; 1027, Discretionary Accounts; 1029, Delivery of Options Disclosure Documents; and 1049, Communications to Customers (collectively, the “Reference Rules”). The Reference Rules proposed amendments are designed to conform the Phlx rules more closely to the corresponding Financial Industry Regulatory Authority, Inc. (“FINRA”) rules.

A notice of the proposed rule change for publication in the Federal Register is attached as Exhibit 1. The text of the proposed rule change is attached as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Board of Directors of the Exchange (the “Board”) on July 25, 2016. No other action is necessary for the filing of the rule change.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

Questions and comments on the proposed rule change may be directed to

Carla Behnfeldt  
Associate General Counsel  
Nasdaq, Inc.  
(215) 496-5208

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

a. Purpose

The purpose of the proposed rule change with respect to the Reference Rules is to harmonize those rules with the corresponding FINRA rules.

The Exchange is a party to a 17d-2 agreement with FINRA and other options exchanges (the "Options Multiparty 17d-2 Agreement" or the "17d-2 Agreement").<sup>3</sup> The 17d-2 Agreement allocates regulatory responsibilities with respect to broker-dealers, and persons associated therewith, that are members of more than one Participant (the "Common Members") and conduct a public business for compliance with specified common rules relating to the conduct by broker-dealers and associated persons of accounts for listed options, index warrants, currency index warrants, and currency warrants (collectively, "Covered Securities").

Pursuant to the 17d-2 Agreement, FINRA is the Designated Options Examining Authority ("DOEA") for its broker-dealer members that also are members of Phlx. Thus,

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<sup>3</sup> See the Agreement by and among BATS Exchange, Inc., BOX Options Exchange, LLC, the Chicago Board Options Exchange, Incorporated, C2 Options Exchange, Incorporated, the International Securities Exchange, LLC, Financial Industry Regulatory Authority, Inc., Miami International Securities Exchange, LLC, the New York Stock Exchange LLC, the NYSE MKT LLC, the NYSE Arca, Inc., The NASDAQ Stock Market LLC, NASDAQ OMX BX, Inc., the NASDAQ OMX PHLX LLC, ISE Gemini, LLC, EDGX Exchange, Inc. and ISE Mercury LLC, Pursuant to Rule 17d-2 under the Securities Exchange Act of 1934. See also Securities Exchange Act Release No. 77148 (February 16, 2016), 81 FR 8775 (February 22, 2016).

FINRA has certain examination and enforcement responsibilities relating to compliance by Common Members with the rules of Phlx that are substantially similar to the rules of FINRA (the “Common Rules”) identified in the 17d-2 Agreement. The purpose of this proposed rule change is to update the four Reference Rules which are currently Common Rules for which FINRA currently has examination and enforcement responsibilities, as well as to amend one Reference Rule to harmonize it with the corresponding FINRA rule so that it may be added to the group of Common Rules for which FINRA currently has examination and enforcement responsibilities. The Exchange seeks to ensure that the rules as amended continue to be “substantially similar” to those of FINRA for purposes of the 17d-2 Agreement.

Rule 1024, Conduct of Accounts for Options Trading

Rule 1024, Conduct of Accounts for Options Trading, currently governs (a) Registration of Options Principals, (b) Opening of Accounts, and (c) the development, implementation and maintenance of specific written procedures governing the conduct of its business with the public in uncovered options contracts. Rule 1024 is a Common Rule under the 17d-2 Agreement.<sup>4</sup>

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<sup>4</sup> The 17d-2 Agreement provides that FINRA shall not have any Regulatory Responsibility regarding foreign currency option requirements specified in any of the PHLX rules covered by that agreement (the “FCO Rules”). The FCO Rules include Rules 1024(a)(ii), Foreign Currency Options-Qualified Customer Personnel, and 1024(b), Opening of Accounts, subsection (i), as well as Rule 1024 Commentary .04.

The Exchange proposes to delete the caption of Section (a), Registration of Options Principals, as well as Subsections (b)(i)-(v), Subsection (c), and the text of Commentary Sections .01 - .03, and .05, (adding in their place the word “Reserved”).<sup>5</sup>

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<sup>5</sup> The deleted text of Rule 1024 section (b)(i), which provides generally that no member or member organization shall accept an order from a customer to purchase or write an option contract or currency or index warrant contract unless the customer’s account has been approved for options trading in accordance with the provisions of this rule, is being replaced by section (A) of Rule 1024 as revised. The deleted text of Rule 1024, Section (b)(ii), generally prescribes the due diligence a member shall exercise in approving a customer’s account for options transactions for the approval of the account by the branch office manager or other specific Registered Options Principal qualified individual. This section is proposed to be replaced by new Rule 1024, Section (B). The deleted text of Rule 1024, Section (b)(iii), provides for the verification of customer background and financial information and is being replaced by new Rule 1024, Section (C). The deleted text of Rule 1024, Section (b)(iv), provides that member organizations shall obtain from the customer a written agreement that the account shall be handled in accordance with the Rules of the Exchange and the rules of the Options Clearing Corporation and that such customer, acting alone or in concert with others, will not violate the position or exercise limits set forth in Rules 1001 and 1002. It is being replaced by new Rule 1024, section (D). The deleted text of Rule 1024, Section (b)(v), requires that at or prior to the time a customer’s account is approved for options transactions, a member organization shall furnish the customer with one or more current Options Disclosure Documents. This section is proposed to be incorporated with changes and replaced by new Rule 1024, Section (A). The deleted text of Rule 1024, Section (c), requires every member organization transacting business with the public in uncovered option contracts to develop, implement and maintain certain specific written procedures governing the conduct of such business. This section is proposed to be replaced by new Rule 1024, Section (E). The deleted text of Rule 1024 Commentary Sections .01 - .03 provides additional detail concerning the due diligence a member is to exercise in approving a customer’s account for options transactions. This section is being incorporated with changes into new Rule 1024, Sections (B) and (C). Deleted Rule 1024 Commentary .05 provides that for purposes of certain rules the term writing uncovered short option positions includes combinations and any transactions which involve naked writing. This section is not being replaced because it is not included in FINRA Rules 2360(b)(16), 2352, and 2360(b)(11), which collectively are identified in the 17d-2 Agreement as Common Rules which correspond to existing Phlx Rule 1024. Existing Rule 1024 Commentary Sections .06 and .07 (dealing with Options Principals) and .08 (dealing with the Series 7 General Securities Registered Representative Examination and registration requirements) are being retained in their current form, without change.

The Exchange is amending Rule 1024 Commentary Section .09(iv) by replacing a reference to the Interagency Statement (Statement on Retail Sales of Nondeposit Investment Products required under Banking Regulations) with a broader reference to signage necessary to comply with applicable federal and state laws, rules and regulations and applicable rules and regulations of other self-regulatory organizations, and securities and banking regulators. This change conforms Rule 1024 Commentary Section .09(iv) to FINRA Rule 3110(f)(2)(A)(iv). Additionally, references in Rule 1024 Commentary Sections .09(ii) and (v) to “advertisements” are replaced with the words “retail communication” to conform the rules more closely to the analogous provisions of FINRA Rule 3110(f)(2)(A). The term “associated person” is modified for clarity in various instances to refer to an “associated person of a member organization”.

The Exchange proposes to adopt “Opening of Accounts” as the new title of Rule 1024. It proposes to add new Section (A), Approval Required; (B), Diligence in Opening Accounts; (C), Verification of Customer Background and Financial Information; (D), Account Agreement; (E), Uncovered Short Option Contract; (F), Warrants, all based on current FINRA rules<sup>6</sup>; and (G), Registration of Options Principals, intended to replace the deleted text.

However, because the Exchange lists foreign currency options which the FINRA rules do not address, the Exchange is retaining existing Phlx rule language regarding foreign currency options that will be set forth in Section (A) of Rule 1024 as revised. That language, which is currently found in Rule 1024(b)(i), provides that no member or

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<sup>6</sup> Specifically, the new language is based upon FINRA Rules 2360(b)(16), 2352, and 2360(b)(11), which collectively are identified in the 17d-2 Agreement as Common Rules which correspond to existing Phlx Rule 1024.

member organization shall accept an order from a customer to purchase or write a foreign currency option contract unless such customer's account has been specially approved by a designated Foreign Currency Options Principal of such member or member organization, in writing, for transactions in foreign currency options. Such approval must be based upon the facts known to the member or member organization concerning the customer and his investment objectives and financial situations.

Rule 1025, Supervision of Accounts

Rule 1025, Supervision of Accounts, currently provides for (a) Duty to Supervise, (b) Maintenance of Customer Records, (c) Internal Controls, (d) Annual Branch Office Inspections, (e) Risk-Based Surveillance and Branch Office Identification, (f) Criteria for Inspection Programs, (g) Written Report, (h) Reports to Control Persons, and (i) Foreign Currency Options Principals.<sup>7</sup> Rule 1025 is a Common Rule under the 17d-2 Agreement. The Exchange proposes to delete Rule 1025 Sections (a) – (h), and Section (j). In addition, it proposes to delete the text found in Rule 1025 Commentary Sections .03 and .05, in each case replacing the deleted text with the word “Reserved.”<sup>8</sup>

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<sup>7</sup> The provisions of Rule 1025 are applicable to currency and index warrants as well as to options.

<sup>8</sup> The deleted text of Rule 1025, Section (a), generally provides that the general partners or directors of each member organization that conducts a non-member customer business shall provide for appropriate supervisory control and shall designate a general partner or executive officer, who shall be identified to the Exchange, to assume overall authority and responsibility for internal supervision and control of the organization and compliance with securities laws and regulations. Rule 1025 Section (a) goes on to detail the specific responsibilities of the person in charge of the supervisory control responsibility. This section is proposed to be replaced by the new Rule 1025, Section (A), which incorporates by reference the systems policies and procedures detailed in Exchange Rule 748, Supervision, which provides that each office, location, department, business activity, trading system and internal surveillance system of a member or member organization (including foreign incorporated branch offices) shall be under the

The Exchange proposes to add new Section (A), Duty to Supervise, Section (B), Branch Offices, Section (C), Headquarters Review of Accounts, Section (D) dealing with maintenance of customer information at branch offices and the principal supervisory office, Section (E) extending Rule 1025 to transactions in warrants, and Section (F) regarding recordkeeping requirements for transactions in warrants, all based on current FINRA rules<sup>9</sup> and intended to replace the deleted text. The Exchange is re-designating existing Rule 1025(i), Foreign Currency Options Principal, as Section (G).<sup>10</sup> It is also retaining Commentary Sections .01 and .04 dealing with responsibilities of and qualifications of Foreign Currency Options Principals, and Commentary Section .02

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supervision and control of the member or member organization establishing it and of an appropriately qualified supervisor. Rule 748 establishes requirements for designation of supervisors, qualification of supervisors, standards for supervision, interviews or meetings and reviews of business, branch offices, office inspections and written supervisory procedures. Deleted Sections (b) – (h) and (j) of Rule 1025 detail requirements relating to maintenance of customer records, internal controls, annual branch office inspections, risk-based surveillance and branch office identification, criteria for annual branch office inspection programs, annual written reports to the Exchange on the member organization’s supervision and compliance effort, delivery of annual reports to control persons, and a statement that the provisions of the rule are applicable to currency and index warrants. Current Rule 1025(b)(i) is replaced by new Rule 1025(D). The deleted text found in Rule 1025 Commentary Section .03 requires maintenance or retrievability of certain specified information to permit review of each customer’s options account on a timely basis, and is replaced by new Rule 1025(C). The deleted text found in Rule 1025 Commentary Section .05 deals with documentation evidencing the annual written report called for in other deleted text, rendering it unnecessary.

<sup>9</sup> Specifically, the new language is based upon FINRA Rules 2360(b)(20), 2360(b)(17)(B), 2360(b)(16)(E), 2355 and 2358 which collectively are identified in the 17d-2 Agreement as the Common Rules which correspond to existing Phlx Rule 1025.

<sup>10</sup> Phlx is retaining this language because the FINRA rules do not cover foreign currency options.

dealing with establishment and enforcement of written procedures governing the conduct of options accounts.<sup>11</sup>

#### Rule 1027, Discretionary Accounts

Rule 1027, Discretionary Accounts, currently provides for the handling of all discretionary options accounts and the approval of all discretionary options transactions. Rule 1027 is a Common Rule under the 17d-2 Agreement. The Exchange proposes to retain the title of the rule, but to delete Rule 1027 Sections (a)(i), (iii) and (iv) as well as Sections (b) – (e) and Commentary .01.<sup>12</sup> The Exchange proposes to adopt new Section

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<sup>11</sup> Rule 1025 applies solely to options. As noted above, the Exchange's rulebook also features a general supervision rule, Rule 748, Supervision, providing that each office, location, department, business activity, trading system and internal surveillance system of a member or member organization (including foreign incorporated branch offices) shall be under the supervision and control of the member or member organization establishing it and of an appropriately qualified supervisor.

<sup>12</sup> Currently, Rule 1027 Sections (a)(i), (iii), and (iv) generally cover the handling of the authorization of all discretionary options accounts and the approval of all discretionary options transactions. The deleted language of Rule 1027 Section (a)(i) is proposed to be replaced by the new Rule 1027, Section (A)(i). The deleted language of Rule 1027 Section (a)(iii) is incorporated into new Rule 1027(A)(ii). The deleted language of Rule 1027 Section (a)(iv) is proposed to be replaced by the new Rule 1027, Section (E). The deleted language of Rule 1027 Section (b) describes written information sent to a customer respect to the nature and risk of the options programs, pursuant to Rule 1049. This section is proposed to be replaced by the new Rule 1027, Section (C). The deleted language of Rule 1027 Section (c), which refers to transactions prohibited to anyone with discretionary power over a customer's account regarding purchases or sales of options contracts which are excessive in size or frequency, is proposed to be replaced by the new Rule 1027, Section (F). The deleted language of Rule 1027 Section (d), which establish the requirement of recording transactions in options contracts and the details to be preserved in those records, is proposed to be replaced by new Rule 1027, Section (B). The deleted language of Rule 1027 Section (e), which refers to an exception from the rules requirements for certain transactions where discretion is limited to execution time and price, is proposed to be replaced by new Rule 1027(A)(ii), which incorporates by reference definitions provided by FINRA Rule 4512(c). The deleted language in Rule 1027 Commentary .01, regarding specific requirements for approval of discretionary

(A), Authorization and Approval, Section (B), Record of Transactions, and Section (C), Options Programs, which are based on current FINRA rules.<sup>13</sup>

The Exchange proposes to retain current language regarding Foreign Currency Options Principal approval of discretionary transactions as Rule 1027 Section (D).<sup>14</sup> This language is currently found in Rule 1027(a)(ii). The Exchange also proposes to retain current language that extends the discretionary trading rule to index warrants and that prohibits trading that is excessive in view of the financial resources in such account at as Sections (E) and (F) respectively. This language, which is being relocated but not otherwise modified, is currently found in Phlx Rules 1027(a)(iv) and 1027(c).

#### Rule 1029, Delivery of Options Disclosure Documents

Rule 1029, Delivery of Options Disclosure Documents, currently requires every member and member organization to deliver a current Options Disclosure Document (the “ODD”) to each customer at or prior to the time such customer’s account is approved for options trading. Rule 1029 is a Common Rule under the 17d-2 Agreement.

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orders in cases where members do not use computerized surveillance tools, is proposed to be replaced by new Rule 1027, Section (A)(iii). Existing Rule 1027(a)(ii), Foreign Currency Options, is being retained in its current form with an updated section number, as shown in proposed Rule 1027(D).

<sup>13</sup> Specifically, the new language is based upon FINRA Rules 2360(b)(18) and 2354 which together are identified in the 17d-2 Agreement as the Common Rules which correspond to existing Phlx Rule 1027.

<sup>14</sup> Phlx is retaining this language because the FINRA rules do not cover foreign currency options.

The Exchange proposes to delete the title and the text of the rule in its entirety.<sup>15</sup> In its place, the Exchange proposes to adopt new Rule 1029, Delivery of Current Disclosure Documents, which is based upon a current FINRA rule.<sup>16</sup>

Rule 1049, Communications to Customers

Rule 1049, Communications to Customers, currently sets forth a range of requirements applicable to members, member organizations, or persons associated with a

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<sup>15</sup> The language in current Rule 1029 details the delivery requirements for the ODD. The deleted language of Rule 1029, Section (a), requires members and member organizations to deliver the current ODD to each customer at or prior to the time such customer's account is approved for trading options, as well as to deliver amended ODDs in certain circumstances. This section is proposed to be replaced by new Rule 1029, Section (A)(i). Moreover, new Rule 1029 Section (A)(iv) provides definitional language in a similar manner to a deleted portion of current Rule 1029, Section (a). The deleted language of Rule 1029, Section (b), specifies the format requirements for the written description of risks currently required by Rule 1024(c)(v) to be in connection with writing uncovered short options transactions. The format requirements are no longer required as Rule 1024(c) itself is being replaced by new Rule 1024, Section E. Rule 1029, Section (b) is thus proposed to be replaced by new Rule 1029, Section (A)(ii). The deleted language of Rule 1029, Commentary .01, describes the duty of a member or member organization with regard to the furnishing of reasonable quantities of current ODDs to his broker or dealer when orders are entered in a single omnibus account. This section is proposed to be replaced by new Rule 1029, Section (B). The deleted language of Rule 1029, Commentary .02, describes a member organization's duty to deliver one or more current ODDs when a broker or dealer enters orders with, or clears transactions through, the member organization; the rule also provides the member organization's reliance upon the broker or dealer's good faith representation for the delivery of ODDs. This section is proposed to be replaced by new Rule 1029, Section (C). Finally, the deleted language of Rule 1029, Commentary .03, refers to the Exchange's duty to advise members and member organizations of the amendment of an ODD. This section is proposed to be replaced by Rule 1029 (A)(iii), which incorporates by reference the requirements of Securities Exchange Act ("SEA") Rule 9b-1.

<sup>16</sup> Specifically, the new language is based upon FINRA Rules 2356 and 2360(b)(11) which is identified in the 17d-2 Agreement as the Common Rule which corresponds to existing Phlx Rule 1029.

member organization utilizing any advertisement, educational material, sales literature or other communications to any customer or member of the public.

Rule 1049 is not currently a Common Rule under the 17d-2 Agreement. The Exchange proposes to retain the title of the rule, but otherwise to delete the rule in its entirety.<sup>17</sup> The Exchange proposes to adopt new Section (a), Definitions, Section (b) Approval by a Registered Options Principal and Recordkeeping, Section (c), FINRA Approval Requirements and Review Procedures, and Section (d), Standards Applicable to Communications, which are based upon current FINRA Rules.<sup>18</sup>

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<sup>17</sup> The deleted language of Rule 1049(a) – (f) generally prohibits members, member organizations and persons associated with a member from utilizing any advertisement, educational material, sales literature, or other communications to any customer or member of the public which is false or misleading. It also contains Registered Options Principal approval requirements for advertisements and certain related recordkeeping and Exchange approval requirements. The deleted Rule 1049 Commentary contains certain content guidelines for advertisements, educational material or sales literature which discusses the uses or advantages or options. Deleted Rule 1049, Section (a), describing the General Rules applied to members, member organization, or persons associated with a member and their use of advertisement, educational materials, or other communications, is proposed to be replaced by the General Standards under new Rule 1049, Section (d)(2)(A)(i) through (iv). Moreover, the proposed General Standards incorporate the deleted text from Rule 1049, Commentary .01 C. into new Rule 1049, Section (d)(2)(A)(v); likewise, the deleted introductory paragraph of Commentary .01 and its subsection (A) are incorporated, respectively, under the proposed General Standards, Sections (d)(2)(A)(vi) and (d)(2)(C). Furthermore, deleted Rule 1049, Commentary .01 B, is proposed to be replaced by new Rule 1049, Section (d)(2)(A)(vii). Deleted Commentary .05, Subsection G, is being replaced by (d)(2)(A)(viii). Sections (b) and (c) of current Rule 1049 are replaced by new Rule 1049 Sections (b) and (c)(1), respectively. Sections (c)(i) and (ii) of existing Rule 1049 are replaced by new Rule 1049 Sections (c)(4)(A) and (B). Section (f) of existing Rule 1049 is replaced by new Rule 1049 Section (d)(7). Rule 1049 Commentary Sections .02, .04 B, .04 C, .04 D, and .05 are replaced by new Rule 1049 Sections (d)(1)(A), (d)(3), (d)(4), (d)(5) and (d)(7) respectively.

<sup>18</sup> Specifically, the new language is based upon FINRA Rules 2220, Options Communications, and 2357, Communications with the Public and Customers Concerning Index Warrants, Currency Index Warrants and Currency Warrants.

b. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>19</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>20</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and to protect investors and the public interest, by conforming the Reference Rules more closely to their FINRA counterpart rules. By doing so, the proposal also furthers the objectives of Section 6(b)(1)<sup>21</sup> of the Act as the amendments would better enable the Exchange to be so organized as to have the capacity to be able to carry out the purposes of the Act and to comply, and to enforce compliance by its members with the provisions of the Act, the rules and regulations thereunder, and the rules of the Exchange.

In its most recent approval order for the 17d-2 Agreement<sup>22</sup> the Commission noted that Section 19(g)(1) of the Act,<sup>23</sup> among other things, requires every self-regulatory organization (“SRO”) registered as either a national securities exchange or national securities association to examine for, and enforce compliance by, its members and persons associated with its members with the Act, the rules and regulations

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<sup>19</sup> 15 U.S.C. 78f(b).

<sup>20</sup> 15 U.S.C. 78f(b)(5).

<sup>21</sup> 15 U.S.C. 78f(b)(1).

<sup>22</sup> See Securities and Exchange Act Release No. 77148 (February 16, 2016).

<sup>23</sup> 15 U.S.C. 78s(g)(1).

thereunder, and the SRO's own rules, unless the SRO is relieved of this responsibility pursuant to Section 17(d)<sup>24</sup> or Section 19(g)(2)<sup>25</sup> of the Act.

Without this relief, the statutory obligation of each individual SRO could result in a pattern of multiple examinations of broker-dealers that maintain memberships in more than one SRO ("common members"). In its decision, the Commission noted that such regulatory duplication would add unnecessary expenses for common members and their SROs. Finally, it observed that under paragraph (c) of Rule 17d-2, the Commission may declare joint plans for the allocation of regulatory responsibilities with respect to their common members effective if, after providing for notice and comment, it determines that the plan is necessary or appropriate in the public interest and for the protection of investors, to foster cooperation and coordination among the SROs, to remove impediments to, and foster the development of, a national market system and a national clearance and settlement system, and is in conformity with the factors set forth in Section 17(d) of the Act.

The 17d-2 Plan covering the Reference Rules is designed to eliminate regulatory duplication and unnecessary expense for common members and the SROs including Phlx, with respect to the Common Rules. By amending the Phlx rules herein, so that they are "substantially similar" to those of FINRA and therefore remain Common Rules for purposes of the 17d-2 Agreement, the Exchange is eliminating regulatory duplication and unnecessary expense as contemplated by Commission Rule 17d-2.

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<sup>24</sup> 15 U.S.C. 78q(d)(1).

<sup>25</sup> 15 U.S.C. 78s(g)(2).

4. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the amendments to the Reference Rules proposed herein will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act inasmuch as the amendments conform those rules more closely to the FINRA rules.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were either solicited or 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)

Not applicable.

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

As noted above the proposed rule change is based on the FINRA rules to which the Reference Rules correspond in the 17d-2 Agreement.

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

1. Notice of proposed rule for publication in the Federal Register.
5. Text of the proposed rule change.

**EXHIBIT 1**

SECURITIES AND EXCHANGE COMMISSION  
(Release No. \_\_\_\_\_ ; File No. SR-Phlx-2016-127)

January \_\_, 2017

Self-Regulatory Organizations; NASDAQ PHLX LLC; Notice of Filing of Proposed Rule Change to Amend Rules 1024, 1025, 1027, 1029, and 1049

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup>, and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 30, 2016, NASDAQ PHLX LLC (“Phlx” or “Exchange”) 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 the Exchange. 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

The Exchange proposes to amend Rules 1024, Conduct of Accounts for Options Trading; 1025, Supervision of Accounts; 1027, Discretionary Accounts; 1029, Delivery of Options Disclosure Documents; and 1049, Communications to Customers (collectively, the “Reference Rules”).

The text of the proposed rule change is available on the Exchange’s Website at <http://nasdaqphlx.cchwallstreet.com/>, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

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

In its filing with the Commission, the Exchange 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. The Exchange 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

The purpose of the proposed rule change with respect to the Reference Rules is to harmonize those rules with the corresponding FINRA rules.

The Exchange is a party to a 17d-2 agreement with FINRA and other options exchanges (the "Options Multiparty 17d-2 Agreement" or the "17d-2 Agreement").<sup>3</sup> The 17d-2 Agreement allocates regulatory responsibilities with respect to broker-dealers, and persons associated therewith, that are members of more than one Participant (the "Common Members") and conduct a public business for compliance with specified common rules relating to the conduct by broker-dealers and associated persons of

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<sup>3</sup> See the Agreement by and among BATS Exchange, Inc., BOX Options Exchange, LLC, the Chicago Board Options Exchange, Incorporated, C2 Options Exchange, Incorporated, the International Securities Exchange, LLC, Financial Industry Regulatory Authority, Inc., Miami International Securities Exchange, LLC, the New York Stock Exchange LLC, the NYSE MKT LLC, the NYSE Arca, Inc., The NASDAQ Stock Market LLC, NASDAQ OMX BX, Inc., the NASDAQ OMX PHLX LLC, ISE Gemini, LLC, EDGX Exchange, Inc. and ISE Mercury LLC, Pursuant to Rule 17d-2 under the Securities Exchange Act of 1934. See also Securities Exchange Act Release No. 77148 (February 16, 2016), 81 FR 8775 (February 22, 2016).

accounts for listed options, index warrants, currency index warrants, and currency warrants (collectively, “Covered Securities”).

Pursuant to the 17d-2 Agreement, FINRA is the Designated Options Examining Authority (“DOEA”) for its broker-dealer members that also are members of Phlx. Thus, FINRA has certain examination and enforcement responsibilities relating to compliance by Common Members with the rules of Phlx that are substantially similar to the rules of FINRA (the “Common Rules”) identified in the 17d-2 Agreement. The purpose of this proposed rule change is to update the four Reference Rules which are currently Common Rules for which FINRA currently has examination and enforcement responsibilities, as well as to amend one Reference Rule to harmonize it with the corresponding FINRA rule so that it may be added to the group of Common Rules for which FINRA currently has examination and enforcement responsibilities. The Exchange seeks to ensure that the rules as amended continue to be “substantially similar” to those of FINRA for purposes of the 17d-2 Agreement.

#### Rule 1024, Conduct of Accounts for Options Trading

Rule 1024, Conduct of Accounts for Options Trading, currently governs (a) Registration of Options Principals, (b) Opening of Accounts, and (c) the development, implementation and maintenance of specific written procedures governing the conduct of its business with the public in uncovered options contracts. Rule 1024 is a Common Rule under the 17d-2 Agreement.<sup>4</sup>

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<sup>4</sup> The 17d-2 Agreement provides that FINRA shall not have any Regulatory Responsibility regarding foreign currency option requirements specified in any of the PHLX rules covered by that agreement (the “FCO Rules”). The FCO Rules include Rules 1024(a)(ii), Foreign Currency Options-Qualified Customer Personnel, and 1024(b), Opening of Accounts, subsection (i), as well as Rule 1024 Commentary .04.

The Exchange proposes to delete the caption of Section (a), Registration of Options Principals, as well as Subsections (b)(i)-(v), Subsection (c), and the text of Commentary Sections .01 - .03, and .05, (adding in their place the word “Reserved”).<sup>5</sup>

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<sup>5</sup> The deleted text of Rule 1024 section (b)(i), which provides generally that no member or member organization shall accept an order from a customer to purchase or write an option contract or currency or index warrant contract unless the customer’s account has been approved for options trading in accordance with the provisions of this rule, is being replaced by section (A) of Rule 1024 as revised. The deleted text of Rule 1024, Section (b)(ii), generally prescribes the due diligence a member shall exercise in approving a customer’s account for options transactions for the approval of the account by the branch office manager or other specific Registered Options Principal qualified individual. This section is proposed to be replaced by new Rule 1024, Section (B). The deleted text of Rule 1024, Section (b)(iii), provides for the verification of customer background and financial information and is being replaced by new Rule 1024, Section (C). The deleted text of Rule 1024, Section (b)(iv), provides that member organizations shall obtain from the customer a written agreement that the account shall be handled in accordance with the Rules of the Exchange and the rules of the Options Clearing Corporation and that such customer, acting alone or in concert with others, will not violate the position or exercise limits set forth in Rules 1001 and 1002. It is being replaced by new Rule 1024, section (D). The deleted text of Rule 1024, Section (b)(v), requires that at or prior to the time a customer’s account is approved for options transactions, a member organization shall furnish the customer with one or more current Options Disclosure Documents. This section is proposed to be incorporated with changes and replaced by new Rule 1024, Section (A). The deleted text of Rule 1024, Section (c), requires every member organization transacting business with the public in uncovered option contracts to develop, implement and maintain certain specific written procedures governing the conduct of such business. This section is proposed to be replaced by new Rule 1024, Section (E). The deleted text of Rule 1024 Commentary Sections .01 - .03 provides additional detail concerning the due diligence a member is to exercise in approving a customer’s account for options transactions. This section is being incorporated with changes into new Rule 1024, Sections (B) and (C). Deleted Rule 1024 Commentary .05 provides that for purposes of certain rules the term writing uncovered short option positions includes combinations and any transactions which involve naked writing. This section is not being replaced because it is not included in FINRA Rules 2360(b)(16), 2352, and 2360(b)(11), which collectively are identified in the 17d-2 Agreement as Common Rules which correspond to existing Phlx Rule 1024. Existing Rule 1024 Commentary Sections .06 and .07 (dealing with Options Principals) and .08 (dealing with the Series 7 General Securities Registered Representative Examination and registration requirements) are being retained in their current form, without change.

The Exchange is amending Rule 1024 Commentary Section .09(iv) by replacing a reference to the Interagency Statement (Statement on Retail Sales of Nondeposit Investment Products required under Banking Regulations) with a broader reference to signage necessary to comply with applicable federal and state laws, rules and regulations and applicable rules and regulations of other self-regulatory organizations, and securities and banking regulators. This change conforms Rule 1024 Commentary Section .09(iv) to FINRA Rule 3110(f)(2)(A)(iv). Additionally, references in Rule 1024 Commentary Sections .09(ii) and (v) to “advertisements” are replaced with the words “retail communication” to conform the rules more closely to the analogous provisions of FINRA Rule 3110(f)(2)(A). The term “associated person” is modified for clarity in various instances to refer to an “associated person of a member organization”.

The Exchange proposes to adopt “Opening of Accounts” as the new title of Rule 1024. It proposes to add new Section (A), Approval Required; (B), Diligence in Opening Accounts; (C), Verification of Customer Background and Financial Information; (D), Account Agreement; (E), Uncovered Short Option Contract; (F), Warrants, all based on current FINRA rules<sup>6</sup>; and (G), Registration of Options Principals, intended to replace the deleted text.

However, because the Exchange lists foreign currency options which the FINRA rules do not address, the Exchange is retaining existing Phlx rule language regarding foreign currency options that will be set forth in Section (A) of Rule 1024 as revised. That language, which is currently found in Rule 1024(b)(i), provides that no member or

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<sup>6</sup> Specifically, the new language is based upon FINRA Rules 2360(b)(16), 2352, and 2360(b)(11), which collectively are identified in the 17d-2 Agreement as Common Rules which correspond to existing Phlx Rule 1024.

member organization shall accept an order from a customer to purchase or write a foreign currency option contract unless such customer's account has been specially approved by a designated Foreign Currency Options Principal of such member or member organization, in writing, for transactions in foreign currency options. Such approval must be based upon the facts known to the member or member organization concerning the customer and his investment objectives and financial situations.

#### Rule 1025, Supervision of Accounts

Rule 1025, Supervision of Accounts, currently provides for (a) Duty to Supervise, (b) Maintenance of Customer Records, (c) Internal Controls, (d) Annual Branch Office Inspections, (e) Risk-Based Surveillance and Branch Office Identification, (f) Criteria for Inspection Programs, (g) Written Report, (h) Reports to Control Persons, and (i) Foreign Currency Options Principals.<sup>7</sup> Rule 1025 is a Common Rule under the 17d-2 Agreement. The Exchange proposes to delete Rule 1025 Sections (a) – (h), and Section (j). In addition, it proposes to delete the text found in Rule 1025 Commentary Sections .03 and .05, in each case replacing the deleted text with the word “Reserved.”<sup>8</sup>

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<sup>7</sup> The provisions of Rule 1025 are applicable to currency and index warrants as well as to options.

<sup>8</sup> The deleted text of Rule 1025, Section (a), generally provides that the general partners or directors of each member organization that conducts a non-member customer business shall provide for appropriate supervisory control and shall designate a general partner or executive officer, who shall be identified to the Exchange, to assume overall authority and responsibility for internal supervision and control of the organization and compliance with securities laws and regulations. Rule 1025 Section (a) goes on to detail the specific responsibilities of the person in charge of the supervisory control responsibility. This section is proposed to be replaced by the new Rule 1025, Section (A), which incorporates by reference the systems policies and procedures detailed in Exchange Rule 748, Supervision, which provides that each office, location, department, business activity, trading system and internal surveillance system of a member or member organization (including foreign incorporated branch offices) shall be under the

The Exchange proposes to add new Section (A), Duty to Supervise, Section (B), Branch Offices, Section (C), Headquarters Review of Accounts, Section (D) dealing with maintenance of customer information at branch offices and the principal supervisory office, Section (E) extending Rule 1025 to transactions in warrants, and Section (F) regarding recordkeeping requirements for transactions in warrants, all based on current FINRA rules<sup>9</sup> and intended to replace the deleted text. The Exchange is re-designating existing Rule 1025(i), Foreign Currency Options Principal, as Section (G).<sup>10</sup> It is also retaining Commentary Sections .01 and .04 dealing with responsibilities of and qualifications of Foreign Currency Options Principals, and Commentary Section .02

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supervision and control of the member or member organization establishing it and of an appropriately qualified supervisor. Rule 748 establishes requirements for designation of supervisors, qualification of supervisors, standards for supervision, interviews or meetings and reviews of business, branch offices, office inspections and written supervisory procedures. Deleted Sections (b) – (h) and (j) of Rule 1025 detail requirements relating to maintenance of customer records, internal controls, annual branch office inspections, risk-based surveillance and branch office identification, criteria for annual branch office inspection programs, annual written reports to the Exchange on the member organization’s supervision and compliance effort, delivery of annual reports to control persons, and a statement that the provisions of the rule are applicable to currency and index warrants. Current Rule 1025(b)(i) is replaced by new Rule 1025(D). The deleted text found in Rule 1025 Commentary Section .03 requires maintenance or retrievability of certain specified information to permit review of each customer’s options account on a timely basis, and is replaced by new Rule 1025(C). The deleted text found in Rule 1025 Commentary Section .05 deals with documentation evidencing the annual written report called for in other deleted text, rendering it unnecessary.

<sup>9</sup> Specifically, the new language is based upon FINRA Rules 2360(b)(20), 2360(b)(17)(B), 2360(b)(16)(E), 2355 and 2358 which collectively are identified in the 17d-2 Agreement as the Common Rules which correspond to existing Phlx Rule 1025.

<sup>10</sup> Phlx is retaining this language because the FINRA rules do not cover foreign currency options.

dealing with establishment and enforcement of written procedures governing the conduct of options accounts.<sup>11</sup>

#### Rule 1027, Discretionary Accounts

Rule 1027, Discretionary Accounts, currently provides for the handling of all discretionary options accounts and the approval of all discretionary options transactions. Rule 1027 is a Common Rule under the 17d-2 Agreement. The Exchange proposes to retain the title of the rule, but to delete Rule 1027 Sections (a)(i), (iii) and (iv) as well as Sections (b) – (e) and Commentary .01.<sup>12</sup> The Exchange proposes to adopt new Section

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<sup>11</sup> Rule 1025 applies solely to options. As noted above, the Exchange's rulebook also features a general supervision rule, Rule 748, Supervision, providing that each office, location, department, business activity, trading system and internal surveillance system of a member or member organization (including foreign incorporated branch offices) shall be under the supervision and control of the member or member organization establishing it and of an appropriately qualified supervisor.

<sup>12</sup> Currently, Rule 1027 Sections (a)(i), (iii), and (iv) generally cover the handling of the authorization of all discretionary options accounts and the approval of all discretionary options transactions. The deleted language of Rule 1027 Section (a)(i) is proposed to be replaced by the new Rule 1027, Section (A)(i). The deleted language of Rule 1027 Section (a)(iii) is incorporated into new Rule 1027(A)(ii). The deleted language of Rule 1027 Section (a)(iv) is proposed to be replaced by the new Rule 1027, Section (E). The deleted language of Rule 1027 Section (b) describes written information sent to a customer respect to the nature and risk of the options programs, pursuant to Rule 1049. This section is proposed to be replaced by the new Rule 1027, Section (C). The deleted language of Rule 1027 Section (c), which refers to transactions prohibited to anyone with discretionary power over a customer's account regarding purchases or sales of options contracts which are excessive in size or frequency, is proposed to be replaced by the new Rule 1027, Section (F). The deleted language of Rule 1027 Section (d), which establish the requirement of recording transactions in options contracts and the details to be preserved in those records, is proposed to be replaced by new Rule 1027, Section (B). The deleted language of Rule 1027 Section (e), which refers to an exception from the rules requirements for certain transactions where discretion is limited to execution time and price, is proposed to be replaced by new Rule 1027(A)(ii), which incorporates by reference definitions provided by FINRA Rule 4512(c). The deleted language in Rule 1027 Commentary .01, regarding specific requirements for approval of discretionary

(A), Authorization and Approval, Section (B), Record of Transactions, and Section (C), Options Programs, which are based on current FINRA rules.<sup>13</sup>

The Exchange proposes to retain current language regarding Foreign Currency Options Principal approval of discretionary transactions as Rule 1027 Section (D).<sup>14</sup> This language is currently found in Rule 1027(a)(ii). The Exchange also proposes to retain current language that extends the discretionary trading rule to index warrants and that prohibits trading that is excessive in view of the financial resources in such account at as Sections (E) and (F) respectively. This language, which is being relocated but not otherwise modified, is currently found in Phlx Rules 1027(a)(iv) and 1027(c).

#### Rule 1029, Delivery of Options Disclosure Documents

Rule 1029, Delivery of Options Disclosure Documents, currently requires every member and member organization to deliver a current Options Disclosure Document (the “ODD”) to each customer at or prior to the time such customer’s account is approved for options trading. Rule 1029 is a Common Rule under the 17d-2 Agreement.

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orders in cases where members do not use computerized surveillance tools, is proposed to be replaced by new Rule 1027, Section (A)(iii). Existing Rule 1027(a)(ii), Foreign Currency Options, is being retained in its current form with an updated section number, as shown in proposed Rule 1027(D).

<sup>13</sup> Specifically, the new language is based upon FINRA Rules 2360(b)(18) and 2354 which together are identified in the 17d-2 Agreement as the Common Rules which correspond to existing Phlx Rule 1027.

<sup>14</sup> Phlx is retaining this language because the FINRA rules do not cover foreign currency options.

The Exchange proposes to delete the title and the text of the rule in its entirety.<sup>15</sup> In its place, the Exchange proposes to adopt new Rule 1029, Delivery of Current Disclosure Documents, which is based upon a current FINRA rule.<sup>16</sup>

Rule 1049, Communications to Customers

Rule 1049, Communications to Customers, currently sets forth a range of requirements applicable to members, member organizations, or persons associated with a

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<sup>15</sup> The language in current Rule 1029 details the delivery requirements for the ODD. The deleted language of Rule 1029, Section (a), requires members and member organizations to deliver the current ODD to each customer at or prior to the time such customer's account is approved for trading options, as well as to deliver amended ODDs in certain circumstances. This section is proposed to be replaced by new Rule 1029, Section (A)(i). Moreover, new Rule 1029 Section (A)(iv) provides definitional language in a similar manner to a deleted portion of current Rule 1029, Section (a). The deleted language of Rule 1029, Section (b), specifies the format requirements for the written description of risks currently required by Rule 1024(c)(v) to be in connection with writing uncovered short options transactions. The format requirements are no longer required as Rule 1024(c) itself is being replaced by new Rule 1024, Section E. Rule 1029, Section (b) is thus proposed to be replaced by new Rule 1029, Section (A)(ii). The deleted language of Rule 1029, Commentary .01, describes the duty of a member or member organization with regard to the furnishing of reasonable quantities of current ODDs to his broker or dealer when orders are entered in a single omnibus account. This section is proposed to be replaced by new Rule 1029, Section (B). The deleted language of Rule 1029, Commentary .02, describes a member organization's duty to deliver one or more current ODDs when a broker or dealer enters orders with, or clears transactions through, the member organization; the rule also provides the member organization's reliance upon the broker or dealer's good faith representation for the delivery of ODDs. This section is proposed to be replaced by new Rule 1029, Section (C). Finally, the deleted language of Rule 1029, Commentary .03, refers to the Exchange's duty to advise members and member organizations of the amendment of an ODD. This section is proposed to be replaced by Rule 1029 (A)(iii), which incorporates by reference the requirements of Securities Exchange Act ("SEA") Rule 9b-1.

<sup>16</sup> Specifically, the new language is based upon FINRA Rules 2356 and 2360(b)(11) which is identified in the 17d-2 Agreement as the Common Rule which corresponds to existing Phlx Rule 1029.

member organization utilizing any advertisement, educational material, sales literature or other communications to any customer or member of the public.

Rule 1049 is not currently a Common Rule under the 17d-2 Agreement. The Exchange proposes to retain the title of the rule, but otherwise to delete the rule in its entirety.<sup>17</sup> The Exchange proposes to adopt new Section (a), Definitions, Section (b) Approval by a Registered Options Principal and Recordkeeping, Section (c), FINRA Approval Requirements and Review Procedures, and Section (d), Standards Applicable to Communications, which are based upon current FINRA Rules.<sup>18</sup>

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<sup>17</sup> The deleted language of Rule 1049(a) – (f) generally prohibits members, member organizations and persons associated with a member from utilizing any advertisement, educational material, sales literature, or other communications to any customer or member of the public which is false or misleading. It also contains Registered Options Principal approval requirements for advertisements and certain related recordkeeping and Exchange approval requirements. The deleted Rule 1049 Commentary contains certain content guidelines for advertisements, educational material or sales literature which discusses the uses or advantages or options. Deleted Rule 1049, Section (a), describing the General Rules applied to members, member organization, or persons associated with a member and their use of advertisement, educational materials, or other communications, is proposed to be replaced by the General Standards under new Rule 1049, Section (d)(2)(A)(i) through (iv). Moreover, the proposed General Standards incorporate the deleted text from Rule 1049, Commentary .01 C. into new Rule 1049, Section (d)(2)(A)(v); likewise, the deleted introductory paragraph of Commentary .01 and its subsection (A) are incorporated, respectively, under the proposed General Standards, Sections (d)(2)(A)(vi) and (d)(2)(C). Furthermore, deleted Rule 1049, Commentary .01 B, is proposed to be replaced by new Rule 1049, Section (d)(2)(A)(vii). Deleted Commentary .05, Subsection G, is being replaced by (d)(2)(A)(viii). Sections (b) and (c) of current Rule 1049 are replaced by new Rule 1049 Sections (b) and (c)(1), respectively. Sections (c)(i) and (ii) of existing Rule 1049 are replaced by new Rule 1049 Sections (c)(4)(A) and (B). Section (f) of existing Rule 1049 is replaced by new Rule 1049 Section (d)(7). Rule 1049 Commentary Sections .02, .04 B, .04 C, .04 D, and .05 are replaced by new Rule 1049 Sections (d)(1)(A), (d)(3), (d)(4), (d)(5) and (d)(7) respectively.

<sup>18</sup> Specifically, the new language is based upon FINRA Rules 2220, Options Communications, and 2357, Communications with the Public and Customers Concerning Index Warrants, Currency Index Warrants and Currency Warrants.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>19</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>20</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and to protect investors and the public interest, by conforming the Reference Rules more closely to their FINRA counterpart rules. By doing so, the proposal also furthers the objectives of Section 6(b)(1)<sup>21</sup> of the Act as the amendments would better enable the Exchange to be so organized as to have the capacity to be able to carry out the purposes of the Act and to comply, and to enforce compliance by its members with the provisions of the Act, the rules and regulations thereunder, and the rules of the Exchange.

In its most recent approval order for the 17d-2 Agreement<sup>22</sup> the Commission noted that Section 19(g)(1) of the Act,<sup>23</sup> among other things, requires every self-regulatory organization (“SRO”) registered as either a national securities exchange or national securities association to examine for, and enforce compliance by, its members and persons associated with its members with the Act, the rules and regulations

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<sup>19</sup> 15 U.S.C. 78f(b).

<sup>20</sup> 15 U.S.C. 78f(b)(5).

<sup>21</sup> 15 U.S.C. 78f(b)(1).

<sup>22</sup> See Securities and Exchange Act Release No. 77148 (February 16, 2016).

<sup>23</sup> 15 U.S.C. 78s(g)(1).

thereunder, and the SRO's own rules, unless the SRO is relieved of this responsibility pursuant to Section 17(d)<sup>24</sup> or Section 19(g)(2)<sup>25</sup> of the Act.

Without this relief, the statutory obligation of each individual SRO could result in a pattern of multiple examinations of broker-dealers that maintain memberships in more than one SRO ("common members"). In its decision, the Commission noted that such regulatory duplication would add unnecessary expenses for common members and their SROs. Finally, it observed that under paragraph (c) of Rule 17d-2, the Commission may declare joint plans for the allocation of regulatory responsibilities with respect to their common members effective if, after providing for notice and comment, it determines that the plan is necessary or appropriate in the public interest and for the protection of investors, to foster cooperation and coordination among the SROs, to remove impediments to, and foster the development of, a national market system and a national clearance and settlement system, and is in conformity with the factors set forth in Section 17(d) of the Act.

The 17d-2 Plan covering the Reference Rules is designed to eliminate regulatory duplication and unnecessary expense for common members and the SROs including Phlx, with respect to the Common Rules. By amending the Phlx rules herein, so that they are "substantially similar" to those of FINRA and therefore remain Common Rules for purposes of the 17d-2 Agreement, the Exchange is eliminating regulatory duplication and unnecessary expense as contemplated by Commission Rule 17d-2.

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<sup>24</sup> 15 U.S.C. 78q(d)(1).

<sup>25</sup> 15 U.S.C. 78s(g)(2).

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the amendments to the Reference Rules proposed herein will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act inasmuch as the amendments conform those rules more closely to the FINRA rules.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were either solicited or received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission shall: (a) by order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be 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](mailto:rule-comments@sec.gov). Please include File Number SR-Phlx-2016-127 on the subject line.

Paper comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-Phlx-2016-127. 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 Web site (<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 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-Phlx-2016-127 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.<sup>26</sup>

Robert W. Errett  
Deputy Secretary

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<sup>26</sup> 17 CFR 200.30-3(a)(12).

**EXHIBIT 5**

Proposed new text is underlined. Deleted text is [bracketed].

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**Options Rules**

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**Rule 1024. [Conduct of Accounts for Options Trading]Opening of Accounts****(A) Approval Required**

No member or person associated with a member organization shall accept an order from a customer to purchase or write an option contract relating to an options class that is the subject of an options disclosure document, or approve the customer's account for the trading of such option, unless the broker or dealer furnishes or has furnished to the customer the appropriate options disclosure document(s) and the customer's account has been approved for options trading in accordance with the provisions of subparagraphs (B) through (D) hereof. In addition, no member or member organization shall accept an order from a customer to purchase or write a foreign currency option contract unless such customer's account has been specially approved by a designated Foreign Currency Options Principal of such member or member organization, in writing, for transactions in foreign currency options. Such approval to engage in foreign currency options transactions shall be based upon the facts known to the member or member organization concerning the customer and his investment objectives and financial situations.

**(B) Diligence in Opening Accounts**

In approving a customer's account for options trading, a member or any person associated with a member organization shall exercise due diligence to ascertain the essential facts relative to the customer, his financial situation and investment objectives. Based upon such information, the branch office manager, a Registered Options Principal or a Limited Principal—General Securities Sales Supervisor shall specifically approve or disapprove in writing the customer's account for options trading; provided, that if the branch office manager is not a Registered Options Principal or a Limited Principal—General Securities Sales Supervisor, account approval or disapproval shall within ten (10) business days be submitted to and approved or disapproved by a Registered Options Principal or a Limited Principal—General Securities Sales Supervisor.

(i) With respect to options customers who are natural persons, members shall seek to obtain the following information at a minimum (information shall be obtained for all participants in a joint account):

- a. Investment objectives (e.g., safety of principal, income, growth, trading profits, speculation);
- b. Employment status (name of employer, self-employed, or retired);

- c. Estimated annual income from all sources;
  - d. Estimated net worth (exclusive of family residence);
  - e. Estimated liquid net worth (cash, securities, other);
  - f. Marital status; number of dependents;
  - g. Age; and
  - h. Investment experience and knowledge (e.g., number of years, size, frequency and type of transactions) for options, stocks and bonds, commodities, and other financial instruments.
- (ii) In addition, a customer's account records shall contain the following information, if applicable:
- a. Source or sources of background and financial information (including estimates) concerning the customer;
  - b. Discretionary authorization agreement on file, name, relationship to customer and experience of person holding trading authority;
  - c. Date disclosure document(s) furnished to customer;
  - d. Nature and types of transactions for which account is approved (e.g., buying covered writing, uncovered writing, spreading, discretionary transactions);
  - e. Name of registered representative;
  - f. Name of Registered Options Principal or Limited Principal—General Securities Sales Supervisor approving account; date of approval; and
  - g. Dates of verification of currency of account information.
- (iii) Members shall consider utilizing a standard account approval form so as to ensure the receipt of all the required information.
- (iv) Refusal of a customer to provide any of the information called for in subparagraph (i) shall be so noted on the customer's records at the time the account is opened. Information provided shall be considered together with the other information available in determining whether and to what extent to approve the account for options trading.
- (v) A record of the information obtained pursuant to this subparagraph and of the approval or disapproval of each such account shall be maintained by the member as part of its permanent records in accordance with Rule 1025(b).

### **(C) Verification of Customer Background and Financial Information**

The background and financial information upon which the account of every new options customer that is a natural person has been approved for options trading, unless the information is included in the customer's account agreement, shall be sent to the customer for verification within fifteen (15) days after the customer's account has been approved for options trading. A copy of the background and financial information on file with a member shall also be sent to the customer for verification within fifteen (15) days after the member becomes aware of any material change in the customer's financial situation. Members shall satisfy the initial and subsequent verification of customer background and financial information by sending to the customer the information required in subparagraphs (B)(i)a. through f. hereof, as contained in the member's records and providing the customer with an opportunity to correct or complete the information. In all cases, absent advice from the customer to the contrary, the information will be deemed to be verified.

**(D) Account Agreement**

Within fifteen (15) days after a customer's account has been approved for options trading, a member shall obtain from the customer a written agreement that the customer is aware of and agrees to be bound by Exchange rules applicable to the trading of option contracts and, if he desires to engage in transactions in options issued by The Options Clearing Corporation, other than solely for OCC Cleared OTC Options, that the customer has received a copy of the current disclosure document(s) required to be furnished hereunder and that he is aware of and agrees to be bound by the rules of The Options Clearing Corporation. In addition, the customer shall indicate on such written agreement that he is aware of and agrees not to violate the position limits established pursuant to Rule 1001 and the exercise limits established pursuant to Rule 1002.

**(E) Uncovered Short Option Contracts**

Each member transacting business with the public in writing uncovered short option contracts shall develop, implement and maintain specific written procedures governing the conduct of such business which shall include, at least, the following:

(i) Specific criteria and standards to be used in evaluating the suitability of a customer for writing uncovered short option transactions;

(ii) Specific procedures for approval of accounts engaged in writing uncovered short option contracts, including written approval of such accounts by a Registered Options Principal;

(iii) Designation of a specific Registered Options Principal(s) as responsible for approving customer accounts that do not meet the specific criteria and standards for writing uncovered short option transactions and for maintaining written records of the reasons for every account so approved;

(iv) Establishment of specific minimum net equity requirements for initial approval and maintenance of customer accounts writing uncovered short option transactions; and

(v) Requirements that customers approved for writing uncovered short options transactions be provided with a special written statement for uncovered option writers approved by the Exchange that describes the risks inherent in writing uncovered short option transactions, at or prior to the initial writing of an uncovered short option transaction.

**(F) Warrants.** No member or person associated with a member organization shall accept an order from a customer to purchase or sell an index warrant, currency index warrant, or currency warrant unless the customer's account has been approved for options trading pursuant to Rule 1024.

**(G) Registration of Options Principals.**

*[(a) Registration of Options Principals.]*

(i) No member or member organization or individual associated with a member organization shall be approved to transact options business with the public until such persons, who are designated as Options Principals, have been approved by and registered with the Exchange. Persons engaged in the supervision of options sales practice or a

person to whom the designated general partner or executive officer (pursuant to Rule 1025) or another Registered Options Principal delegates the authority to supervise options sales practices shall be designated as Options Principals. All members, and member organizations must use Web CRD to submit Form U4, Uniform Application for Securities Industry Registration or Transfer filings on behalf of their Options Principals. Members and member organizations shall amend Form U4 filings not later than thirty (30) days after the filer knew or should have known of the facts which gave rise to the amendment.

(ii) *Foreign Currency Options-Qualified Customer Personnel*—Registered Representatives of a member organization may solicit or accept customer orders for foreign currency options. Otherwise, an Application for Waiver of Series 7 Examination may be submitted describing and certifying at least six months of options-related experience. Such waiver is not automatic, but is subject to approval based on the information contained in the application.

[(b) Opening of Accounts

(i) No member or member organization shall accept an order from a customer to purchase or write an option contract or currency or index warrant contract unless the customer's account has been approved for options trading in accordance with the provisions of this Rule. In addition, no member or member organization shall accept an order from a customer to purchase or write a foreign currency option contract unless such customer's account has been specially approved by a designated Foreign Currency Options Principal of such member or member organization, in writing, for transactions in foreign currency options. Such approval to engage in foreign currency options transactions shall be based upon the facts known to the member or member organization concerning the customer and his investment objectives and financial situations.

(ii) *Diligence in Opening Accounts*—In approving a customer's account for options transactions, a member or member organization shall exercise due diligence to learn the essential facts as to the customer and his investment objectives and financial situation, and shall make a record of such information which shall be retained in accordance with Rules 760 and 1025. Based upon such information, the branch office manager or other specific Registered Options Principal qualified individual(s) shall approve, in writing, the customer's account for options transactions; provided, that if the branch office manager is not a specified Registered Options Principal qualified individual(s), his approval shall be confirmed within a reasonable time by a specified Registered Options Principal qualified individual(s).

(iii) *Verification of Customer Background and Financial Information*—The background and financial information upon which the account of every new customer that is a natural person has been approved for options trading, unless the information is included in the customer's account agreement, shall be sent to the customer for verification within fifteen (15) days after the customer's account has been approved for options transactions. A copy of the background and financial information on file with the member organization shall

also be sent to the customer for verification within fifteen (15) days after the member organization becomes aware of any material change in the customer's financial situation.

(iv) *Agreements to Be Obtained*—Within fifteen (15) days after a customer's account has been approved for options transactions, a member organization shall obtain from the customer a written agreement that the account shall be handled in accordance with the Rules of the Exchange and the rules of the Options Clearing Corporation and that such customer, acting alone or in concert with others, will not violate the position or exercise limits set forth in Rules 1001 and 1002.

(v) *Options Disclosure Documents to be Furnished*—At or prior to the time a customer's account is approved for options transactions, a member organization shall furnish the customer with one or more current Options Disclosure Documents in accordance with the requirements of Rule 1029.

(c) Every member organization transacting business with the public in uncovered option contracts shall develop, implement and maintain specific written procedures governing the conduct of such business which shall include, at least, the following:

(i) Specific criteria and standards to be used in evaluating the suitability of a customer for uncovered short option transactions;

(ii) Specific procedures for approval of accounts engaged in writing uncovered short option contracts, including written approval of such accounts by a Registered Options Principal;

(iii) Designation of a specific Registered Options Principal qualified individual(s) as the person(s) responsible for approving accounts which do not meet the specific criteria and standards for writing uncovered short option transactions and for maintaining written records of the reasons for every account so approved;

(iv) Establishment of specific minimum net equity requirements for initial approval and maintenance of customer uncovered option accounts; and

(v) Requirements that customers approved for writing uncovered short options transactions be provided with a special written description of the risks inherent in writing uncovered short option transactions, at or prior to the initial uncovered short option transaction. See Rule 1029(c).]

••• *Commentary* -----

**.01 Reserved.** [In fulfilling its obligations pursuant to paragraph (b)(ii) of this Rule with respect to options customers that are natural persons, a member organization shall seek to obtain the following information at a minimum (information shall be obtained for all participants in a joint account):

1. Investment objectives (e.g., safety of principal, income, growth, trading profits, speculation)
2. Employment status (name of employer, self-employed or retired)
3. Estimated annual income from all sources
4. Estimated net worth (exclusive of family residence)
5. Estimated liquid net worth (cash, securities, other)
6. Marital status: number of dependents
7. Age
8. Investment experience and knowledge (e.g., number of years, size, frequency and types of transactions) for options, stocks and bonds, commodities, other

In addition, the customer's account records shall contain the following information, if applicable:

- a. Source or sources of background and financial information (including estimates) concerning the customer
- b. Discretionary trading authorization: agreement on file; name; relationship to customer and experience of person holding trading authority
- c. Date Options Disclosure Document(s) furnished to customer
- d. Nature and types of transactions for which account is approved (e.g., buying, covered writing, uncovered writing, spreading, discretionary transactions)
- e. Name of registered representative
- f. Name of ROP approving account; date of approval
- g. Dates of verification of currency of account information

The member organization should consider utilizing a standard account approval form so as to ensure the receipt of all the required information.]

**.02** [Refusal of a customer to provide any of the information called for in Commentary .01 shall be so noted on the customer's records at the time the account is opened. Information provided shall be considered together with other information available in determining

whether and to what extent to approve the account for options transactions. ]**Reserved.**

**.03** [The requirement of paragraph (b)(iii) of this Rule for the initial and subsequent verification of customer background and financial information is to be satisfied by sending to the customer the information required in Items 1 through 6 of Commentary .01 above as contained in the member's records and providing the customer with opportunity to correct or complete the information. In all cases, absent advice from the customer to the contrary, the information will be deemed to be verified. ]**Reserved.**

**.04** Approval of the accounts of customers for foreign currency options transactions shall be conducted in accordance with this Rule and, in the case of customers that are natural persons, shall include consideration of the background and financial information that a member organization must seek to obtain under [Commentary .01 to ]this Rule. With respect to institutional foreign currency options customers (i.e., customers that are not natural persons), a member organization shall seek to obtain the following information.

- (i) evidence of authority for the institution to engage in foreign currency options transactions (corporate resolutions, trust documents, etc.);
- (ii) written designations of individuals within the institution authorized to act for it in connection with foreign currency options transactions; and
- (iii) basic financial information concerning the institution.

**.05** [For purposes of Rule 1024 (Conduct of Accounts for Options Trading) Rule 1025 (Supervision of Accounts) and Rule 1029 (Delivery of Options Disclosure Document), the term writing uncovered short option positions shall include combinations and any transactions which involve naked writing. ]**Reserved.**

**.06** Individuals engaged in the supervision of options sales practices and designated as Options Principals are required to qualify as an Options Principal by passing the Registered Options Principal Qualification Examination (Series 4) or the Sales Supervision Qualification Examination (Series 9/10).

**.07** Individuals who are delegated responsibility pursuant to Rule [1025]1027 for the acceptance of discretionary accounts, for approving exceptions to a member organization's criteria or standards for uncovered options accounts, and for approval of communications, shall be designated as Options Principals and are required to qualify

as an Options Principal by passing the Registered Options Principal Qualification Examination (Series 4).

**.08** A person accepting orders from non-member customers (unless such customer is a broker-dealer registered with the Securities and Exchange Commission) is required to register with the Exchange and to be qualified by passing the General Securities Registered Representative Examination (Series 7).

**.09** Definition of Branch Office. A "branch office" is any location where one or more associated persons of a member [or member] organization regularly conduct the business of effecting any transactions in, or inducing or attempting to induce the purchase or sale of any security, or is held out as such, excluding:

- (i) any location that is established solely for customer service and/or back office type functions where no sales activities are conducted and that is not held out to the public as a branch office;
- (ii) any location that is the primary residence of a member organization's associated person[s primary residence]; provided that: (a) only one associated person, or multiple associated persons who reside at that location and are members of the same immediate family, conduct business at the location; (b) the location is not held out to the public as an office and the associated person does not meet with customers at the location; (c) neither customer funds nor securities are handled at that location; (d) the associated person is assigned to a designated branch office, and such branch office is reflected on all business cards, stationery, [advertisements] and other communications to the public by such associated person; (e) the associated person's correspondence and communications with the public are subject to all supervisory provisions of the Exchange's Rules; (f) electronic communications (e.g., e-mail) are made through the member's or member organization's electronic system; (g) all orders are entered through the designated branch office or an electronic system established by the member or member organization that is reviewable at the branch office; (h) written supervisory procedures pertaining to supervision of sales activities conducted at the residence are maintained by the member or member organization; and (i) a list of the locations is maintained by the member or member organization;
- (iii) any location, other than a primary residence, that is used for securities business for less than 30 business days in any one calendar year, provided the member or member organization complies with the provisions of (b) through (h) of paragraph (ii) above;
- (iv) any office of convenience, where the associated person of a member organization occasionally and exclusively by appointment meets with customers, which is not held out to the public as a branch office [(where such location is on bank premises, however, only signage required by the Interagency Statement (Statement on Retail

Sales of Nondeposit Investment Products required under Banking Regulations) may be displayed) ](provided, however, that where such office of convenience is located on bank premises, signage necessary to comply with applicable federal and state laws, rules and regulations and applicable rules and regulations of other self-regulatory organizations, and securities and banking regulators may be displayed and shall not be deemed "holding out" for purposes of this section);

- (v) any location that is used primarily to engage in non-securities activities and from which the associated person of a member organization effects no more than 25 securities transactions in any one calendar year; provided that any [advertisements]retail communications or sales literature identifying such location also sets forth the address and telephone number of the location from which the associated person of a member organization conducting business at the non-branch locations are directly supervised;
- (vi) the Floor of a registered national securities exchange where a member or member organization conducts a direct access business with public customers; or
- (vii) a temporary location established in response to the implementation of a business continuity plan.

Notwithstanding the exclusions in subparagraphs ([1]i) - (vii) above, any location that is responsible for supervising the activities of persons associated with a member [or member ]organization at one or more non-branch locations of such member or member organization is considered to be a branch office.

For purposes of this Rule, the term "business day" shall not include any partial business day provided that the associated person of a member organization spends at least four hours on such business day at his or her designated branch office during the hours that such office is normally open for business.

For purposes of this Rule, the term "associated person of a member [or member ]organization" is defined as a member, allied member, or employee associated with a member [or member ]organization.

For purposes of (ii)(h) above, written supervisory procedures shall include criteria for on-site for cause reviews of an associated person's primary residence. Such reviews must utilize risk-based sampling or other techniques designed to assure compliance with applicable securities laws and regulations and with Exchange Rules.

For purposes of (ii)(h) and (iii) above, written supervisory procedures for such residences and other remote locations must be designed to

assure compliance with applicable securities laws and regulations and with Exchange Rules.

Factors which should be considered when developing risk-based sampling techniques to determine the appropriateness of on-site for cause reviews of selected residences and other remote locations shall include, but not be limited to, the following: (i) the firm's size; (ii) the firm's organizational structure; (iii) the scope of business activities; (iv) the number and location of offices; (v) the number of associated persons of a member organization assigned to a location; (vi) the nature and complexity of products and services offered; (vii) the volume of business done; (viii) whether the location has a Series 9/10-qualified person on-site; (ix) the disciplinary history of the registered persons or associated persons of a member organization, including a review of such person's customer complaints and Forms U4 and U5; and (x) the nature and extent of a registered person's or associated person's outside business activities, whether or not related to the securities business.

## **Rule 1025. Supervision of Accounts**

### **(A) Duty to Supervise**

Each member that conducts a public customer options business shall ensure that its written supervisory system policies and procedures pursuant to Exchange Rule 748 adequately address the member's public customer options business.

### **(B) Branch Offices**

No branch office of a member shall transact an options business unless the principal supervisor of such branch office accepting options transactions has been qualified as either a Registered Options Principal or a Limited Principal—General Securities Sales Supervisor; provided that this requirement shall not apply to branch offices in which no more than three registered representatives are located, so long as the options activities of such branch offices are appropriately supervised by either a Registered Options Principal or a Limited Principal—General Securities Sales Supervisor.

### **(C) Headquarters Review of Accounts**

Each member shall maintain at the principal supervisory office having jurisdiction over the office servicing customer accounts, or have readily accessible and promptly retrievable, information to permit review of each customer's options account on a timely basis to determine:

- (i) the compatibility of options transactions with investment objectives and with the types of transactions for which the account was approved;
- (ii) the size and frequency of options transactions;
- (iii) commission activity in the account;
- (iv) profit or loss in the account;
- (v) undue concentration in any options class or classes, and

(vi) compliance with the provisions of Regulation T of the Federal Reserve Board.

(D) Background and financial information of customers who have been approved for options trading shall be maintained at both the branch office servicing the customer's account and the principal supervisory office having jurisdiction over that branch office. Copies of account statements of options customers shall also be maintained at both the branch office supervising the accounts and the principal supervisory office having jurisdiction over that branch for the most recent six-month period. With respect solely to the above-noted record retention requirements applicable to principal supervisory offices, however, the customer information and account statements may be maintained at a location other than the principal supervisory office if such documents and information are readily accessible and promptly retrievable. Other records necessary to the proper supervision of accounts shall be maintained at a place easily accessible both to the branch office servicing the customer's account and to the principal supervisory office having jurisdiction over that branch office.

(E) The provisions of sections (A) – (C) of this Rule 1025 shall apply to all customer accounts of a member in which transactions in index warrants, currency index warrants, or currency warrants are effected. The term "option" as used therein shall be deemed to include such warrants for purposes of this Rule.

(F) The record-keeping provisions of Rule 1025(D) above shall be applicable to customer accounts approved to trade index warrants, currency index warrants, or currency warrants. The term "option" as used therein shall be deemed to include such warrants for purposes of this Rule.

*[(a) Duty to Supervise; —*The general partners or directors of each member organization that conducts a non-member customer business shall provide for appropriate supervisory control and shall designate a general partner or executive officer, who shall be identified to the Exchange, to assume overall authority and responsibility for internal supervision and control of the organization and compliance with securities laws and regulations. This person, who may be the same individual designated pursuant to substantially similar New York Stock Exchange or FINRA rules shall:

- (i) Delegate to qualified employees responsibilities and authority for supervision and control of each office, department or business activity, and shall provide for appropriate written procedures of supervision and control.
- (ii) Establish a separate system of follow-up and review to determine that the delegated authority and responsibility is being properly exercised.
- (iii) Develop and implement written policies and procedures reasonably designed to independently supervise the activities of accounts serviced by branch office managers, sales managers, regional/district sales managers or any person performing a similar supervisory function. Such supervisory reviews must be performed by a qualified Registered Options Principal who:

- A. Is either senior to, or otherwise independent of, the producing manager under review. For purposes of this Rule, an "otherwise independent" person: may not report either directly or indirectly to the producing manager under review; must be situated in an office other than the office of the producing manager; must not otherwise have supervisory responsibilities over the activity being reviewed; and must alternate such review responsibility with another qualified person every two years or less. Further, if a person designated to review a producing manager receives an override or other income derived from that producing manager's customer activity that represents more than 10% of the designated person's gross income derived from the member organization over the course of a rolling twelve-month period, the member organization must establish alternative senior or otherwise independent supervision of that producing manager to be conducted by a qualified Registered Options Principal other than the designated person receiving the income.
- B. If a member organization is so limited in size and resources that there is no qualified Registered Options Principal senior to, or otherwise independent of, the producing manager to conduct the reviews pursuant to paragraph (a)(iii)(A) of this Rule (for instance, the member organization has only one office, or an insufficient number of qualified personnel who can conduct reviews on a two-year rotation), the reviews may be conducted by a Registered Options Principal in compliance with paragraph (a)(iii)(A) of this Rule to the extent practicable.
- C. A member organization relying on paragraph (a)(iii)(B) of this Rule must document the factors used to determine that complete compliance with all of the provisions of paragraph (a)(iii)(A) of this Rule is not possible, and that the required supervisory systems and procedures in place with respect to any producing manager comply with the provisions of paragraph (a)(iii)(A) of this Rule to the extent practicable.
- D. A member organization that complies with requirements of the New York Stock Exchange or FINRA that are substantially similar to the requirements in paragraphs (a)(iii)(A), (a)(iii)(B) and (a)(iii)(C) of this Rule will be deemed to have met such requirements.

(b) Maintenance of Customer Records—

- (i) Backgrounds and financial information of customers who have been approved for options transactions shall be maintained at both the branch office servicing the customer's account and the principal supervisory office having jurisdiction over that branch office. Copies of account statements of options customers shall be maintained at both the branch office supervising the accounts and the principal supervisory office having jurisdiction over that branch for the most recent six-month period. With respect to the above-noted record retention requirements applicable to principal supervisory offices, however, the customer information and account statements may be maintained at a location other than the principal supervisory

office if such documents and information are readily accessible and promptly retrievable. Other records necessary to the proper supervision of accounts shall be maintained at a place easily accessible both to the branch office servicing the customer's account and to the principal supervisory office having jurisdiction over that branch office.

- (ii) Upon the written instructions of a customer, a member may hold mail for a customer who will not be at his or her usual address for the period of his or her absence, but (A) not to exceed two months if the member is advised that such customer will be on vacation or traveling or (b) not to exceed three months if the customer is going abroad.
- (iii) Before any customer order is executed, there must be placed upon the memorandum for each transaction, the name or designation of the account (or accounts) for which such order is to be executed. No change in such account name(s) (including related accounts) or designation(s) (including error accounts) shall be made unless the change has been authorized by a member or a person(s) designated by the designated general partner or executive officer (pursuant to Rule 1025). Such person must, prior to giving his or her approval of the account designation change, be personally informed of the essential facts relative thereto and indicate his or her approval of such change in writing on the order or other similar record of the member. The essential facts relied upon by the person approving the change must be documented in writing and preserved for a period of not less than three years, the first two years in an easily accessible place, as the term "easily accessible place" is used in SEC rule 17a-4.

For purposes of this paragraph (b)(3), a person designated by the designated general partner or executive officer (pursuant to Rule 1025) must be a Registered Options Principal.

(c) *Internal Controls.*

- (i) Member organizations must develop and maintain adequate controls over each of its business activities. Such controls must provide for the establishment of procedures for verification and testing of those business activities. An ongoing analysis, based upon appropriate criteria, may be employed to assess and prioritize those business activities requiring independent verification and testing. A review of each member organization's efforts with respect to internal controls, including a summary of tests conducted and significant exceptions identified, must be included in the annual report required by paragraph (g) of this Rule.
- (ii) A member organization that complies with requirements of the New York Stock Exchange or FINRA that are substantially similar to the requirements in paragraph (c)(i) of this Rule will be deemed to have met such requirements.

(d) *Annual Branch Office Inspections.*

- (i) Each branch office that supervises one or more non-branch locations must be inspected no less often than once each calendar year unless:
  - A. it has been demonstrated to the satisfaction of the Exchange that because of the proximity, special reporting or supervisory practice, other arrangements may satisfy this Rule's requirements for a particular branch office; or
  - B. based upon the written policies and procedures of such member organization providing for a systematic risk-based surveillance system, the member organization submits a proposal to the Exchange and receives, in writing, an exemption from this requirement pursuant to paragraph (c) of this Rule.
- (ii) Every branch office, without exception, must be inspected at least once every three calendar-years. All required inspections must be conducted by a person who is independent of the direct supervision and control of the branch office in question (i.e., not the branch office manager, or any person who directly or indirectly reports to such manager, or any person to whom such manager directly reports). Written reports reflecting the results of such inspections are to be maintained at the member organization for the longer of three years or until the next branch office inspection.
- (iii) A member organization that complies with requirements of the New York Stock Exchange or FINRA that are substantially similar to the requirements in paragraph (d)(1) and (d)(2) of this Rule as well as to related requirements in paragraphs (e) and (f) of this Rule will be deemed to have met such requirements.

(e) *Risk -Based Surveillance and Branch Office Identification.*

- (i) Any member organization seeking an exemption, pursuant to Rule 1025(d)(ii), from the annual branch office inspection requirement must submit to the Exchange written policies and procedures for systematic risk-based surveillance of its branch offices. Such policies and procedures should reflect, among other factors, the member organization's business model, and product mix. Such policies and procedures must also, at a minimum, provide for:
  - A. The inspection of branches where developments during the year require a reconsideration of such branch's exemption;
  - B. A requirement that no less than half of the branch offices inspected each year on a cycle basis be done on an unannounced basis; and
  - C. A system to enable employees to report compliance issues on a confidential basis outside of the branch office chain of command.
- (ii) For purposes of paragraph (e)(1) of this Rule, the risk-based factors to be considered should include, but not necessarily be limited to, the following:

- A. Number of Registered Representatives;
- B. A significant increase in the number of Registered Representatives;
- C. Number of customers and volume of transactions;
- D. A significant increase in branch office revenues;
- E. Incidence of concentrated securities positions in customer's accounts;
- F. Aggregate customer assets held;
- G. Nature of the business conducted and the sales practice risk to investors associated with the products sold, and product mix (e.g. options, equities, mutual funds, annuities, etc.);
- H. Numbers of accounts serviced on a discretionary basis;
- I. Compliance and regulatory history of the branch, including:
  - (1) Registered Representatives subject to special supervision by the member organization, self-regulatory authorities, state regulatory authorities or the Securities and Exchange Commission in years other than the previous or current year;
  - (2) Complaints, arbitrations, internal discipline, or prior inspection findings; and
  - (3) Persons subject to recent disciplinary actions by self-regulatory authorities, state regulatory authorities or the Securities and Exchange Commission.
- J. Operational factors, such as the number of errors and account designation changes per Registered Representative;
- K. Incidence of accommodation mailing addresses (e.g., post office boxes and "care of" accounts);
- L. Whether the branch office permits checks to be picked up by customers or hand delivery of checks to customers;
- M. Experience, function (producing or non-producing) and compensation structure of branch office manager;
- N. Branch offices recently opened or acquired; and
- O. Changes in branch location, status or management personnel.

(iii) Notwithstanding any policies or procedures implemented pursuant to this Rule, branch offices that meet any of the following criteria must be inspected no less often than once each calendar year:

- A. Offices with one or more Registered Representatives subject to special supervision as required by a self-regulatory authority or state regulatory authority during the current or immediately preceding year.
- B. Offices with 25 or more registered individuals;
- C. Offices in the top 20% of production or customer assets for the member organization;
- D. Any branch office not inspected within the previous two calendar years; and
- E. Any branch office designated as exercising supervision over another branch office.

(f) *Criteria for Inspection Programs.* An annual branch office inspection program must include, but is not limited to, testing and independent verification of internal controls related to the following areas:

- (i) Safeguarding of customer funds and securities;
- (ii) Maintaining books and records;
- (iii) Supervision of customer accounts serviced by branch office managers;
- (iv) Transmittal of funds between customers and Registered Representatives and between customers and third parties;
- (v) Validation of customer address changes; and
- (vi) Validation of changes in customer account information.

(g) *Written Report.* By April 1 of each year, each member organization that conducts a non-member customer business shall submit to the Exchange a written report on the member organization's supervision and compliance effort during the preceding year. Each member organization that conducts a public customer options business shall also specifically include its options compliance program in the report. The report shall include, but not be limited to, the following:

- (i) A tabulation of customer complaints (including arbitrations and civil actions) and internal investigations.

- (ii) Identification and analysis of significant compliance problems, plans for future systems or procedures to prevent and detect violations and problems, and an assessment of the preceding year's efforts of this nature.
- (iii) Discussion of the preceding year's compliance efforts, new procedures, educational programs, etc. in each of the following areas:
  - (A) antifraud and trading practices;
  - (B) investment banking activities;
  - (C) sales practices
  - (D) books and records
  - (E) finance and operations
  - (F) supervision;
  - (G) internal controls; and
  - (H) anti-money laundering.

If any of these areas do not apply to the member organization, the report shall so state.

- (iv) for each member organization, the designation of a general partner or principal executive officer as Chief Compliance Officer (which designation shall be updated on Schedule A of Form BD).
- (v) A certification signed by the member organization's Chief Executive Officer (or equivalent), that:
  - A. The member organization has in place processes to:
    - (1) establish and maintain policies and procedures reasonably designed to achieve compliance with applicable Exchange Rules and federal securities laws and regulations,
    - (2) modify such policies and procedures as business, regulatory and legislative changes and events dictate, and
    - (3) test the effectiveness of such policies and procedures on a regular basis, the timing and extent of which is reasonably designed to ensure continuing compliance with Exchange Rules and federal securities laws and regulations.

- B. In member organizations, the Chief Executive Officer (or equivalent officer) conducted one or more meetings with the organization's Chief Compliance Officer during the preceding 12 months, and that they discussed and reviewed the matters described in this certification, including the organization's prior compliance efforts, and identified and addressed significant compliance problems and plans for emerging business areas.
- C. In member organizations, the processes described in paragraph (g)(5)(i) of this Rule, are evidenced in a report reviewed by the Chief Executive Officer (or equivalent officer), Chief Compliance Officer and such other officers as the organization may deem necessary to make this certification, and submitted to the organization's board of directors and audit committee (if such committee exists on or before April 1 of each year).
- D. In member organizations, the Chief Executive Officer (or equivalent officer) has consulted with the Chief Compliance Officer and other officers referenced in paragraph (g)(5)(iii) of this Rule and such other employees, outside consultants, lawyers and accountants, to the extent they deem appropriate, in order to attest to the statements made in this certification.

A member organization that specifically includes its options compliance program in a report that complies with substantially similar requirements of the New York Stock Exchange or FINRA will be deemed to have met this requirement of this Rule 1025 (g) and (h).

(h) Reports to Control Persons—By April 1 of each year, each member organization shall submit a copy of the report that Rule 1024(g) requires the member organization to prepare to its one or more control persons or, if the member organization has no control person, to the audit committee of its board of directors or its equivalent committee or group. In the case of a control person that is an organization (a "controlling organization"), the member organization shall submit the report to the general counsel of the controlling organization and to the audit committee of the controlling organization's board of directors or its equivalent committee or group.]

[(i)](G) Foreign Currency Options Principal—Every member handling public orders for foreign currency options shall designate and specifically identify to the Exchange one or more principals of the organization who shall be responsible for supervision of the member organization's non-member customer accounts and communications to customers insofar as such accounts and communications relate to foreign currency options. Each designated Foreign Currency Options Principal shall be a general partner, an officer or a person of appropriate supervisory or managerial rank of the member and shall have successfully completed a Registered Options Principal Qualification Examination, allied member's examination or other principal's examination or have demonstrated equivalent knowledge, and an examination prescribed by the Exchange for the purpose of demonstrating an adequate knowledge of foreign currency options and the markets for the underlying foreign currencies.

[(j) The provisions of this Rule are applicable to currency and index warrants.]

••• *Commentary* -----

**.01** A designated Foreign Currency Options Principal, in meeting his responsibility for supervision of nonmember customer accounts and orders, may delegate to qualified employees responsibility and authority, as provided above in the case of the Senior Registered Options Principal.

**.02** In meeting their supervisory responsibilities, each member organization that conducts a non-member customer business shall establish, maintain, and enforce written procedures governing the conduct of options accounts. Such written procedures shall specifically identify the titles and positions of individuals who have been delegated authority and responsibility for an identified segment of the member organization's business, including option compliance functions. The procedures shall also include the registration status and location of all such supervisory and compliance personnel. Each member organization shall also develop and implement specific written procedures concerning the manner of supervision of customer accounts maintaining short uncovered option positions, and specifically providing for frequent supervisory review of such accounts.

**.03 Reserved.** [Each member organization shall maintain, at the principal supervisory office having jurisdiction over the office servicing the customer's account, or have readily accessible and promptly retrievable, information to permit review of each customer's options account, on a timely basis to determine (i) the compatibility of options transactions with investment objectives and with the types of transactions for which the account was approved; (ii) the size and frequency of option transactions; (iii) commission activity in the account; (iv) profit or loss in the account; (v) undue concentration in any options class or classes; and (vi) compliance with the provisions of Regulation T of the Federal Reserve Board.]

**.04** As a general matter, supervisory qualifications of a designated Foreign Currency Options Principal may be demonstrated only by successful completion of a registered options principal examination, allied member's examination or other principal examination. In exceptional circumstances, however, the Exchange may, upon written request by a member organization, accept as a demonstration of equivalent knowledge other evidence of a designated Foreign Currency Options Principal's supervisory qualifications. Advanced age, physical infirmity or experience in fields ancillary to the foreign

exchange trading, investment banking or securities businesses will not individually of themselves constitute sufficient grounds to excuse a designated Foreign Currency Options Principal from the general requirement that supervisory qualifications be shown by successful completion of an appropriate examination.

.05 [Documentation evidencing the annual written report required by paragraph (g) of this Rule, must be maintained in a place that is easily accessible and shall be provided to the Exchange upon request.]Reserved.

## **Rule 1027. Discretionary Accounts**

### **(A) Authorization and Approval**

(i) No member and no person associated with a member organization shall exercise any discretionary power with respect to trading in option contracts in a customer's account, or accept orders for option contracts for an account from a person other than the customer, except in compliance with the provisions of Exchange rules and unless:

a. The written authorization of the customer required by any Exchange rule shall specifically authorize options trading in the account; and

b. the account shall have been accepted in writing by a Registered Options Principal or Limited Principal—General Securities Sales Supervisor.

(ii) Each firm shall designate specific Registered Options Principals as described below to review discretionary accounts. A Registered Options Principal other than the Registered Options Principal or Limited Principal—General Securities Sales Supervisor who accepted the account shall review the acceptance of each discretionary account to determine that the Registered Options Principal or Limited Principal—General Securities Sales Supervisor accepting the account had a reasonable basis for believing that the customer was able to understand and bear the risk of the strategies or transactions proposed, and shall maintain a record of the basis for such determination. Every discretionary order shall be identified as discretionary on the order at the time of entry. Discretionary accounts shall receive frequent appropriate supervisory review by a Registered Options Principal who is not exercising the discretionary authority. The provisions of this rule shall not apply to discretion as to the price at which or the time when an order given by a customer for the purchase or sale of a definite number of option contracts in a specified security or foreign currency shall be executed, except that the authority to exercise time and price discretion will be considered to be in effect only until the end of the business day on which the customer granted such discretion, absent specific, written contrary indication signed and dated by the customer. This limitation shall not apply to time and price discretion exercised in an institutional account, as defined in FINRA Rule 4512(c) pursuant to valid Good-Till-Cancelled instructions issued on a "not held" basis. Any exercise of time and price discretion must be reflected on the order ticket.

(iii) Any member that does not utilize computerized surveillance tools for the frequent and appropriate review of discretionary activity must establish and implement procedures to require specific Registered Options Principals who have been designated to review discretionary accounts to approve and initial each discretionary order on the day entered.

**(B) Record of Transactions**

A record shall be made of every transaction in option contracts in respect to which a member or person associated with a member organization has exercised discretionary authority, clearly reflecting such fact and indicating the name of the customer, the designation and number of the option contracts, the premium and the date and time when such transaction was effected.

**(C) Option Programs**

Where the discretionary account utilizes options programs involving the systematic use of one or more options strategies, the customer shall be furnished with a written explanation of the nature and risks of such programs.

*[(a) Authorization and Approval Required.* The authorization of all discretionary options accounts and the approval of all discretionary options transactions shall be handled as follows:

- (i) *Stock or Exchange-Traded Fund Share Options*—No member and no partner or employee of a member organization shall exercise any discretionary power with respect to trading in stock or Exchange-Traded Fund Share options contracts in a customer's account unless such customer has given prior written authorization and the account has been accepted in writing by a Registered Options Principal. Each firm shall designate specific Registered Options Principal qualified individuals pursuant to Rule 1025 to review discretionary accounts. A Registered Options Principal qualified person specifically delegated such responsibilities under Rule 1025 (who is an individual other than the Registered Options Principal who accepted the account) shall review the acceptance of each discretionary account to determine that the Registered Options Principal accepting the account had a reasonable basis for believing that the customer was able to understand and bear the risks of the strategies or transactions proposed, and he shall maintain a record of the basis for his determination. Every discretionary order shall be identified as discretionary at the time of entry. Discretionary accounts shall receive frequent review by a Registered Options Principal qualified person specifically delegated such responsibilities under Rule 1025, who is not exercising the discretionary authority.
- (ii) **(D) Foreign Currency Options**—No member and no partner or employee of a member organization shall exercise any discretionary power with respect to trading in foreign currency options contracts in a customer's account unless such customer has given prior written authorization with respect to such trading and the account has been accepted in writing by a designated Foreign Currency Options Principal,

who shall maintain a record of the basis for his determination that such customer was able to understand and bear the risks of the strategies or transactions proposed. Such designated Foreign Currency Options Principal must approve and initial each discretionary foreign currency options order on the day entered unless such order has already been approved and initialed by a Registered Options Principal, provided that in the case of approvals by Registered Options Principals who are not designated Foreign Currency Options Principals, such approvals shall be confirmed within a reasonable time by a designated Foreign Currency Options Principal.

**(E) Index Warrants**

The provisions of this Rule are applicable to index warrants.

**(F) Prohibited Transactions**

No member and no partner, officer, or employee of a member organization having discretionary power over a customer's account shall, in the exercise of such discretion, execute or cause to be executed therein any purchases or sales of option contracts which are excessive in size or frequency in view of the financial resources in such account.

- [(iii) *General*—Every discretionary order shall be identified as discretionary on the order at the time of entry. Discretionary accounts shall receive frequent appropriate supervisory review by the Compliance Registered Options Principal. The provisions of this paragraph (a) shall not apply to discretion as to the price at which or the time when an order given by a customer for the purchase or sale of a definite number of option contracts in a specified security or foreign currency shall be executed.
- (iv) The provisions of this Rule are applicable to index warrants.
- (b) *Options Programs*—Where the discretionary account utilizes options programs involving the systematic use of one or more options strategies, the customer shall be furnished with a written explanation meeting the requirements of Rule 1049 of the nature and risks of such programs.
- (c) *Prohibited Transactions*—No member and no partner, officer or employee of a member organization having discretionary power over a customer's account shall, in the exercise of such discretion, execute or cause to be executed therein any purchases or sales of option contracts which are excessive in size or frequency in view of the financial resources in such account.
- (d) *Record of Transactions*—A record shall be made of every transaction in option contracts in respect to which a member or a partner, officer or employee of a member organization has exercised discretionary authority, clearly reflecting such fact and indicating the name of the customer, the designation and number of the option contracts, the premium and the date and time when such transaction was effected.

(e) *Discretion as to Time or Price Excepted*—This Rule shall not apply to discretion as to the price at which or the time when an order given by a customer for the purchase or sale of a definite number of option contracts in a specified security shall be executed, except that the authority to exercise time and price discretion will be considered to be in effect only until the end of the business day on which the customer granted such discretion, absent a specific, written contrary indication signed and dated by the customer. This limitation shall not apply to time and price discretion exercised in an institutional account, as defined below, pursuant to valid Good-Till-Cancelled instructions issued on a "not held" basis. Any exercise of time and price discretion must be reflected on the order ticket. As used in this paragraph (d) the term "institutional account" shall mean the account of: (i) a bank, savings and loan association, insurance company, or registered investment company; (ii) an investment adviser registered either with the Securities and Exchange Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); or (iii) any other entity (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least \$50 million.

••• *Commentary* -----

.01 Any member organization that does not utilize computerized surveillance tools for the frequent and appropriate review of discretionary account activity must establish and implement procedures to require Registered Options Principal qualified individuals who have been designated to review discretionary accounts to approve and initial each discretionary order on the day entered.]

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**Rule 1028.** No change.

**Rule 1029. [Delivery of Options Disclosure Documents]**

**Delivery of Current Disclosure Documents**

(A)(i) Characteristics and Risks of Standardized Options (the "ODD"). Every member shall deliver the current ODD to each customer at or prior to the time such customer's account is approved for trading options issued by The Options Clearing Corporation, other than an OCC Cleared OTC Option. Thereafter, a copy of each amendment to the ODD shall be distributed to each customer to whom the member previously delivered the ODD not later than the time a confirmation of a transaction in the category of options to which the amendment pertains is delivered to such customer.

(ii) Special Statement for Uncovered Option Writers ("Special Written Statement"). In the case of customers approved for writing uncovered short

options transactions, the Special Written Statement required by Rule 1024(E) shall be in a format prescribed by the Exchange and delivered to customers in accordance with Rule 1024(E). A copy of each new or revised Special Written Statement shall be distributed to each customer having an account approved for writing uncovered short options not later than the time a confirmation of a transaction is delivered to each customer who enters into a transaction in options issued by The Options Clearing Corporation, other than an OCC Cleared OTC Option.

(iii) The Exchange will advise members when a new or revised current disclosure document meeting the requirements of SEA Rule 9b-1 is available.

(iv) For purposes of this rule, the term "OCC Cleared OTC Option" means any put, call, straddle or other option or privilege that meets the definition of an "option" under FINRA Rule 2360(a)(21), and is cleared by The Options Clearing Corporation, 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.

(B) Where a broker or dealer enters his orders with another member in a single omnibus account, the member holding the account shall take reasonable steps to assure that such broker or dealer is furnished reasonable quantities of current disclosure documents, as requested by him in order to enable him to comply with the requirements of SEA Rule 9b-1.

(C) Where an introducing broker or dealer enters orders for his customers with, or clears transactions through, a member on a fully disclosed basis and that member carries the accounts of such customers, the responsibility for delivering the current disclosure document(s) as provided in this paragraph shall rest with the member carrying the accounts. However, such member may rely upon the good faith representation of the introducing broker or dealer that the current disclosure document(s) has been delivered in compliance with this paragraph.

*[(a) Options Disclosure Documents—Every member and member organization shall deliver a current Options Disclosure Document to each customer at or prior to the time such customer's account is approved for options trading. Thereafter, each amended Options Disclosure Document shall be distributed to every customer having an account approved for trading the options class(es) to which such Options Disclosure Document relates, or, in the alternative, shall be distributed not later than the time a confirmation of a transaction is delivered to each customer who enters into an option transaction pertaining to such an options class. The term "current Options Disclosure Document" means the most recent edition of such Document which meets the requirements of Rule 9b-1 promulgated under the Securities Exchange Act of 1934.*

(b) The written description of risks required by Rule 1024(c)(v) shall be in a format prescribed by the Exchange or in a format developed by the member organization,

provided it contains substantially similar information as the prescribed Exchange format and has received prior written approval of the Exchange.

••• *Commentary* -----

.01 Where the customer of a member or member organization is a broker or dealer entering his orders with the member or member organization in a single omnibus account, such member or member organization shall take reasonable steps to assure that such broker or dealer is furnished reasonable quantities of current Options Disclosure Documents, as requested by him in order to enable him to comply with the requirements of this Rule.

.02 Where a broker or dealer enters orders for his customers with, or clears transactions through, a member organization on a fully disclosed basis and such member organization carries the accounts of such customers, the responsibility for delivering one or more current Options Disclosure Documents as provided in this Rule shall rest with the member organization. However, such member organization may rely upon the good faith representation of the introducing broker or dealer that one or more current Options Disclosure Documents have been delivered in compliance with this Rule.

.03 The Exchange will advise members and member organizations when an Options Disclosure Document is amended.]

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## **Rule 1049. Communications to Customers**

### **(a) Definitions**

For purposes of this Rule and any interpretation thereof:

(1) "Options communications" consist of:

(A) "Correspondence." Any "Correspondence" as defined in FINRA Rule 2210(a)(2) concerning options.

(B) "Institutional Communication." Any "Institutional Communication" as defined in FINRA Rule 2210(a)(3) concerning options.

(C) "Retail Communication." Any "Retail Communication" as defined in FINRA Rule 2210(a)(5) concerning options including worksheet templates.

(2) "Standardized option" means any option contract issued, or subject to issuance, by The Options Clearing Corporation, that has standardized terms for the strike price,

expiration date, and amount of the underlying security, and is traded on a national securities exchange registered pursuant to Section 6(a) of the Exchange Act.

(3) "Option" as defined in FINRA Rule 2360(a).

(4) "Options disclosure document" has the same meaning as the term "disclosure document" as defined in FINRA Rule 2360(a).

**(b) Approval by a Registered Options Principal and Recordkeeping**

(1) Retail Communications. All retail communications (except completed worksheets) issued by a member concerning options shall be approved in advance by a Registered Options Principal designated by the member's written supervisory procedures.

(2) Correspondence. Correspondence need not be approved by a Registered Options Principal prior to use. All correspondence is subject to the supervision and review requirements of FINRA Rules 3110(b) and 3110.06 through .09.

(3) Institutional Communications. Each member shall establish written procedures that are appropriate to its business, size, structure, and customers for the review by a Registered Options Principal of institutional communications used by the member and its registered representatives as described in FINRA Rule 2210(b)(3).

(4) Copies of the options communications shall be retained by the member in accordance with SEA Rule 17a-4. The names of the persons who prepared the options communications, the names of the persons who approved the options communications, and the source of any recommendations contained therein, shall be retained by the member and be kept in the form and for the time period required for options communications by SEA Rule 17a-4.

**(c) FINRA Approval Requirements and Review Procedures**

(1) In addition to the approval required by paragraph (b) of this Rule, all retail communications issued by a member concerning standardized options used prior to delivery of the applicable current options disclosure document or prospectus shall be submitted to the Advertising Regulation Department of FINRA (the "Department") at least ten calendar days prior to use (or such shorter period as the Department may allow in particular instances) for approval and, if changed or expressly disapproved by the Department, shall be withheld from circulation until any changes specified by the Department have been made or, in the event of disapproval, until such options communication has been resubmitted for, and has received, Department approval.

(2)(A) Notwithstanding the foregoing provision, the Department, upon review of a member's options communications, and after determining that the member has departed

from the standards of this Rule, may require that such member file some or all options communications or the portions of such member's communications that are related to options with the Department, at least ten calendar days prior to use.

(B) The Department shall notify the member in writing of the types of options communications to be filed and the length of time such requirement is to be in effect. The requirement shall not exceed one year, however, and shall not take effect until 21 calendar days after service of the written notice, during which time the member may request a hearing under FINRA Rules 9551 and 9559.

(3) In addition to the foregoing requirements, every member's options communications shall be subject to a routine spot-check procedure. Upon written request from the Department, each member shall promptly submit the communications requested. Members will not be required to submit communications under this procedure that have been previously submitted pursuant to one of the foregoing requirements.

(4) The requirements of this paragraph (c) shall not be applicable to:

(A) options communications submitted to another self-regulatory organization having comparable standards pertaining to such communications;

(B) communications in which the only reference to options is contained in a listing of the services of the member;

(C) the options disclosure document; and

(D) the prospectus.

**(d) Standards Applicable to Communications**

**(1) Communications Regarding Standardized Options used Prior to Delivery of Options Disclosure Document**

(A) Options communications regarding standardized options exempted under Securities Act Rule 238 used prior to options disclosure document delivery:

(i) must be limited to general descriptions of the options being discussed. The text may also contain a brief description of options, including a statement that identifies registered clearing agencies for options and a brief description of the general attributes and method of operation of the exchanges on which such options are traded, including a discussion of how an option is priced;

(ii) must contain contact information for obtaining a copy of the options disclosure document;

(iii) must not contain recommendations or past or projected performance figures, including annualized rates of return, or names of specific securities;

(iv) may include any statement required by any state law or administrative authority; and

(v) may include advertising designs and devices, including borders, scrolls, arrows, pointers, multiple and combined logos and unusual type faces and lettering as well as attention-getting headlines and photographs and other graphics, provided such material is not misleading.

(B) Options communications regarding options not exempted under Securities Act Rule 238 used prior to delivery of a prospectus that meets the requirements of Section 10(a) of the Securities Act must conform to Securities Act Rule 134 or 134a, as applicable.

## **(2) General Standards**

(A) No member or associated person of a member organization shall use any options communications which:

(i) contains any untrue statement or omission of a material fact or is otherwise false or misleading;

(ii) contains promises of specific results, exaggerated or unwarranted claims, opinions for which there is no reasonable basis or forecasts of future events which are unwarranted or which are not clearly labeled as forecasts;

(iii) contains cautionary statements or caveats that are not legible, are misleading, or are inconsistent with the content of the material;

(iv) would constitute a prospectus as that term is defined in the Securities Act, unless it meets the requirements of Section 10 of the Securities Act;

(v) contains statements suggesting the certain availability of a secondary market for options;

(vi) fails to reflect the risks attendant to options transactions and the complexities of certain options investment strategies;

(vii) fails to include a warning to the effect that options are not suitable for all investors or contains suggestions to the contrary; or

(viii) fails to include a statement that supporting documentation for any claims (including any claims made on behalf of options programs or the options expertise of sales persons), comparison, recommendations, statistics, or other technical data, will be supplied upon request.

(B) Subparagraphs (vii) and (viii) above shall not apply to institutional communications as defined in paragraph (a) of this Rule.

(C) Any statement in any options communications referring to the potential opportunities or advantages presented by options shall be balanced by a statement of the corresponding risks. The risk statement shall reflect the same degree of specificity as the statement of opportunities, and broad generalities must be avoided.

### **(3) Projections**

Options communications may contain projected performance figures (including projected annualized rates of return) provided that:

(A) all such communications regarding standardized options are accompanied or preceded by the options disclosure document;

(B) no suggestion of certainty of future performance is made;

(C) parameters relating to such performance figures are clearly established (e.g., to indicate exercise price of option, purchase price of the underlying stock and its market price, option premium, anticipated dividends, etc.);

(D) all relevant costs, including commissions, fees, and interest charges (as applicable ) are disclosed and reflected in the projections;

(E) such projections are plausible and are intended as a source of reference or a comparative device to be used in the development of a recommendation;

(F) all material assumptions made in such calculations are clearly identified (e.g., "assume option expires," "assume option unexercised," "assume option exercised," etc.);

(G) the risks involved in the proposed transactions are also disclosed; and

(H) in communications relating to annualized rates of return, that such returns are not based upon any less than a 60-day experience; any formulas used in making calculations are clearly displayed; and a statement is included to the effect that the annualized returns cited might be achieved only if the parameters described can be duplicated and that there is no certainty of doing so.

### **(4) Historical Performance**

Options communications may feature records and statistics that portray the performance of past recommendations or of actual transactions, provided that:

(A) all such communications regarding standardized options are accompanied or preceded by the options disclosure document;

(B) any such portrayal is done in a balanced manner, and consists of records or statistics that are confined to a specific "universe" that can be fully isolated and circumscribed and that covers at least the most recent 12-month period;

(C) such communications include the date of each initial recommendation or transaction, the price of each such recommendation or transaction as of such date, and the date and price of each recommendation or transaction at the end of the period or when liquidation was suggested or effected, whichever was earlier; provided that if the communications are limited to summarized or averaged records or statistics, in lieu of the complete record there may be included the number of items recommended or transacted, the number that advanced and the number that declined, together with an offer to provide the complete record upon request;

(D) all relevant costs, including commissions, fees, and daily margin obligations (as applicable) are disclosed and reflected in the performance;

(E) whenever such communications contain annualized rates of return, all material assumptions used in the process of annualization are disclosed;

(F) an indication is provided of the general market conditions during the period(s) covered, and any comparison made between such records and statistics and the overall market (e.g., comparison to an index) is valid;

(G) such communications state that the results presented should not and cannot be viewed as an indicator of future performance; and

(H) a Registered Options Principal determines that the records or statistics fairly present the status of the recommendations or transactions reported upon and so initials the report.

### **(5) Options Programs**

In communications regarding an options program (i.e., an investment plan employing the systematic use of one or more options strategies), the cumulative history or unproven nature of the program and its underlying assumptions shall be disclosed.

### **(6) Violation of Other Rules**

Any violation by a member or associated person of a member organization of any rule or requirement of the SEC or any rule of the Securities Investor Protection Corporation applicable to member communications concerning options will be deemed a violation of this rule.

(7) Warrants. The provisions of this rule shall be applicable to communications to customers regarding index warrants, currency index warrants, or currency warrants. The term "option" as used therein shall be deemed to include such warrants for purposes of

this Rule and the term "The Options Clearing Corporation" shall be deemed to mean the issuer of such warrants.

[(a) *General Rule.* No member or member organization or person associated with a member shall utilize any advertisement, educational material, sales literature or other communications to any customer or member of the public concerning options which:

- (i) contains any untrue statement or omission of a material fact or is otherwise false or misleading;
- (ii) contains promises of specific results, exaggerated or unwarranted claims, opinions for which there is no reasonable basis or forecasts of future events which are unwarranted or which are not clearly labelled as forecasts;
- (iii) contains hedge clauses or disclaimers which are not legible, which attempt to disclaim responsibility for the content of such literature or for opinions expressed therein, or which are otherwise inconsistent with such communication; or
- (iv) would constitute a prospectus as that term is defined in the Securities Act of 1933, unless it meets the requirements of Section 10 of said Act.

(b) *Approval by Registered Options Principal.* All advertisements, sales literature (except completed worksheets) and educational material issued by a member or member organization pertaining to options shall be approved in advance by a Registered Options Principal designated by the member or member organization's written supervisory procedures. Copies thereof, together with the names of the persons who approved the material and, in the case of sales literature, the source of any recommendations contained therein, shall be retained by the member or member organization and be kept at an easily accessible place for examination by the Exchange for a period of three years.

(c) *Exchange Approval Required for Options Advertisements and Educational Material.* In addition to the approval required by paragraph (b) of this Rule, every advertisement and all educational material of a member or member organization pertaining to options shall be submitted to the Exchange at least ten days prior to use (or such shorter period as the Exchange may allow in particular instances) for approval and, if changed or expressly disapproved by the Exchange, shall be withheld from circulation until any changes specified by the Exchange have been made or, in the event of disapproval, until the advertisement or educational material has been resubmitted for, and has received, Exchange approval. The requirements of this paragraph shall not be applicable to:

- (i) advertisements or educational material submitted to another self-regulatory organization having comparable standards pertaining to advertisements or educational material; and
- (ii) advertisements or educational material in which the only reference to options is contained in a listing of the services of a member organization.

(d) Except as otherwise provided in the Commentary hereunder, no written materials respecting options may be disseminated to any person who has not previously or contemporaneously received one or more current Options Disclosure Documents.

(e) *Definitions.* For purposes of this Rule, the following definitions shall apply:

- (i) The term "advertisement" shall include any sales material that reaches a mass audience through public media such as newspapers, periodicals, magazines, radio, television, telephone recording, motion picture, audio or video device, telecommunications device, billboards, signs, or through written communications to customers or the public not required to be accompanied or preceded by one or more current Options Disclosure Documents.
- (ii) The term "educational material" shall include any explanatory material distributed or made generally available to customers or the public that is limited to information describing the general nature of the standardized options markets or one or more strategies.
- (iii) The term "sales literature" shall include any written communication (not defined as an "advertisement" or as "educational material") distributed or made available to customers or the public that contains any analysis, performance report, projection or recommendation with respect to options, underlying securities or market conditions, any standard forms of worksheets, or any seminar text which pertains to options and which is communicated to customers or the public at seminars, lectures or similar such events, or any Exchange-produced materials pertaining to options.

(f) The provisions of this Rule are applicable to index warrants.

••• *Commentary:* -----

**.01** The special risks attendant to options transactions and the complexities of certain options investment strategies shall be reflected in any advertisement, educational material or sales literature which discusses the uses or advantages of options. Such communications shall include a warning to the effect that options are not suitable for all investors. In the preparation of written communications respecting options, the following guidelines should be observed:

- A. Any statement referring to the potential opportunities or advantages presented by options shall be balanced by a statement of the corresponding risks. The risk statement shall reflect the same degree of specificity as the statement of opportunities, and broad generalities should be avoided. Thus, a statement such as "with options, an investor has an opportunity to earn profits while limiting his risk of loss", should be balanced by a statement such as "of course, an options investor may lose the entire amount committed to options in a relatively short period of time".

- B. It shall not be suggested that options are suitable for all investors.
- C. Statements suggesting the certain availability of a secondary market for options shall not be made.

**.02** Advertisements pertaining to options shall conform to the following standards:

- A. Advertisements may only be used (and copies of the advertisements may be sent to persons who have not received one or more Options Disclosure Documents) if the material meets the requirements of rule 134 under the Securities Exchange Act of 1933, as that rule has been interpreted as applying to options. Under rule 134, advertisements must be limited to general descriptions of the security being offered and of its issuer. Advertisements under this Rule shall state the name and address of the person from whom a current Options Disclosure Document(s) may be obtained. Such advertisements may have the following characteristics:
- (i) The text of the advertisement may contain a brief description of such options, including a statement that the issuer of every such option is the Options Clearing Corporation. The text may also contain a brief description of the general attributes and method of operation of the exchange or exchanges on which such options are traded and of the Option Clearing Corporation, including a discussion of how the price of an option is determined on the trading floor(s) of such exchange(s):
  - (ii) The advertisement may include any statement required by any State law or administrative authority;
  - (iii) Advertising designs and devices, including borders, scrolls, arrows, pointers, multiple and combined logos and unusual type faces and lettering as well as attention-getting headlines and photographs and other graphics may be used, provided such material is not misleading.
- B. The use of recommendations or of past or projected performance figures, including annualized rates of return, is not permitted in any advertisement pertaining to options.

**.03** Educational material, including advertisements, pertaining to options may be used if the material meets the requirements of rule 134a under the Securities Act of 1933 (the "Act"). Those requirements are as follows:

- (i) The potential risks related to options trading generally and to each strategy addressed are explained;
- (ii) No past or projected performance figures, including annualized rates of return are used;

- (iii) No recommendation to purchase or sell any option contract is made;
- (iv) No specific security is identified other than
  - (a) a security which is exempt from registration under the Act or an option on such exempt security, or
  - (b) an index option, including the component securities of the index, or
  - (c) a foreign currency option and
- (v) The material contains the name and address of a person or persons from whom the appropriate current Options Disclosure Documents(s), as defined in rule 9b-1 of the Securities Exchange Act of 1934, may be obtained.

**.04** Sales literature pertaining to options shall conform to the following standards:

- A. Sales literature shall state that supporting documentation for any claims (including any claims made on behalf of options programs or the options expertise of salespersons), comparisons, recommendations, statistics or other technical data, will be supplied upon request.
- B. Such communications may contain projected performance figures (including projected annualized rates of return), provided that:
  - (i) no suggestion of certainty of future performance is made;
  - (ii) parameters relating to such performance figures are clearly established (e.g., to indicate exercise price of option, purchase price of the underlying stock and its market price, option premium, anticipated dividends, etc.);
  - (iii) all relevant costs, including commissions and interest charges (if applicable with regard to margin transactions) are disclosed;
  - (iv) such projections are plausible and are intended as a source of reference or a comparative device to be used in the development of a recommendation;
  - (v) all material assumptions made in such calculations are clearly identified (e.g., "assume option exercised", etc.);
  - (vi) the risks involved in the proposed transactions are also discussed;
  - (vii) in communications relating to annualized rates of return, that such returns are not based upon any less than a sixty- day experience; any formulas used in making calculations are clearly displayed; and a statement is included to the effect

that the annualized returns cited might be achieved only if the parameters described can be duplicated and that there is no certainty of doing so.

- C. Such communications may feature records and statistics which portray the performance of past recommendations or of actual transactions provided that:
- (i) any such portrayal is done in a balanced manner, and consists of records or statistics that are confined to a specific "universe" that can be fully isolated and circumscribed and that covers at least the most recent 12-month period;
  - (ii) such communications include the date of each initial recommendation or transaction, the price of each such recommendation or transaction as of such date, and the date and price of each recommendation or transaction at the end of the period or when liquidation was suggested or effected, whichever was earlier; provided that if the communications are limited to summarized or averaged records or statistics, in lieu of the complete record there may be included the number of items recommended or transacted, the number that advanced and the number that declined, together with an offer to provide the complete record upon request;
  - (iii) such communications disclose all relevant costs, including commissions and interest charges (if applicable with regard to margin transactions) and, whenever annualized rates of return are used, all material assumptions used in the process of annualization;
  - (iv) an indication is provided of the general market conditions during the period(s) covered, and any comparison made between such records and statistics and the overall market (e.g., comparison to an index) is valid;
  - (v) such communications state that the results presented should not and cannot be viewed as an indicator of future performance; and
  - (vi) a Registered Options Principal determines that the records or statistics fairly present the status of the recommendations or transactions reported upon and so initials the report.
- D. In the case of an options program (i.e., an investment plan employing the systematic use of one or more options strategies), the cumulative history or unproven nature of the program and its underlying assumptions shall be disclosed.
- E. Standard forms of options worksheets utilized by member organizations, in addition to complying with the requirements applicable to sales literature, must be uniform within a member organization for each product type (e.g. equity, foreign currency, index, etc.).

- F. If a member organization has adopted a standard form of worksheet for a particular options strategy, nonstandard worksheets for that strategy may not be used.
- G. Communications that portray performance of past recommendations or actual transactions and completed worksheets shall be kept at a place easily accessible to the sales office for the accounts or customers involved.

**.05** For purposes of this Rule, the term "option" shall be deemed to include index warrants, and the term "The Options Clearing Corporation" shall be deemed to mean the issuer(s) of such warrants.]

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