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Page 1 of * 41

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No.* SR - 2019 - * 53

Amendment No. (req. for Amendments *)

Filing by Nasdaq PHLX LLC

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * ☑ Amendment * ☐ Withdrawal ☐

Section 19(b)(2) * ☐ Section 19(b)(3)(A) * ☑ Section 19(b)(3)(B) * ☐

Pilot ☐

Extension of Time Period for Commission Action * ☐

Date Expires *

Rule

☐ 19b-4(f)(1) ☐ 19b-4(f)(4)
☐ 19b-4(f)(2) ☐ 19b-4(f)(5)
☐ 19b-4(f)(3) ☑ 19b-4(f)(6)

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010

Section 806(e)(1) * ☐ Section 806(e)(2) * ☐

Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934

Section 3C(b)(2) * ☐

Exhibit 2 Sent As Paper Document ☐ Exhibit 3 Sent As Paper Document ☐

Description

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

A proposal to adopt a new Rule 1059

Contact Information

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

First Name * Sun Last Name * Kim
Title * Associate General Counsel
E-mail * sun.kim@nasdaq.com
Telephone * (212) 231-5106 Fax

Signature

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

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

Date 12/04/2019
By John Zecca
(Name *)

(Title *)
EVP and Chief Legal Officer

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.

john.zecca@nasdaq.com

Required fields are shown with yellow backgrounds and asterisks.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS 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

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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

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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")[1] and Rule 19b-4 thereunder,[2] is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposal to adopt a new Rule 1059 titled "In-Kind Exchange of Options Positions and ETF Shares."

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 senior management of the Exchange pursuant to authority delegated by the Board of Directors of the Exchange (the "Board") on September 25, 2019. Exchange staff will advise the Board of any action taken pursuant to delegated authority. No other action is necessary for the filing of the rule change.

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

Sun Kim
Associate General Counsel
Nasdaq, Inc.
212-231-5106

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

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

a. Purpose

The Exchange proposes to adopt a new Rule 1059 titled "In-Kind Exchange of Options Positions and ETF Shares," based on recent changes proposed by Cboe Exchange, Inc. ("Cboe") and approved by the Commission.[3]

Background

As discussed further below, the ability to effect "in kind" transfers is a key component of the operational structure of an exchange-traded fund ("ETF"). Currently, in general, ETFs can effect in-kind transfers with respect to equity securities and fixed-income securities. The in-kind process is a major benefit to ETF shareholders and, in general, the means by which assets may be added to or removed from ETFs. In-kind transfers protect ETF shareholders from the undesirable tax effects of frequent "creations and redemptions" (described below) and improve the overall tax efficiency of the products. However, currently, the Exchange Rules do not provide for ETFs to effect in-kind transfers of options off of the Exchange, resulting in tax inefficiencies for ETFs that hold them. As a result, the use of options by ETFs is substantially limited.

Currently, Rule 1058(a) permits members or member organizations to transfer their positions off of the Exchange in specified, limited circumstances. The circumstances currently listed include: (1) the dissolution of a joint account in which the remaining member or member organization assumes the positions of the joint account;

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[3] See Cboe Rule 6.9. See also Securities Exchange Act Release No. 87340 (October 17, 2019) (SR-CBOE-2019-048) (Order Approving on an Accelerated Basis a Proposed Rule Change, as Modified by Amendment Nos. 2 and 3, to Adopt Rule 6.9 (In-Kind Exchange of Options Positions and ETF Shares)).

(2) the dissolution of a corporation or partnership in which a former nominee of that corporation or partnership assumes the positions; (3) positions transferred as part of a member or member organization's capital contribution to a new joint account, partnership, or corporation; (4) the donation of positions to a not-for-profit corporation; (5) the transfer of positions to a minor under the Uniform Gifts to Minors Act; (6) a merger or acquisition resulting in a continuity of ownership or management; and (7) consolidation of accounts within a member or member organization.[4] At present, the list of limited circumstances in Rule 1058(a) that allows members to transfer their options positions off the Exchange does not include an exception for in-kind transfers.

The Exchange proposes to add a new circumstance under which off-Exchange transfers of options positions would be permitted to occur. Specifically, under proposed Rule 1059, positions in options listed on the Exchange would be permitted to be transferred off the Exchange by a member or member organization in connection with transactions to purchase or redeem "creation units" of ETF shares between an "authorized participant"[5] and the issuer[6] of such ETF shares,[7] which transfers would occur at the price

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4 The Exchange notes that other options exchanges have adopted rules that provide for off-Exchange transfers under similar circumstances. See, e.g., Cboe Rule 6.7(a); and NYSE Arca, Inc. Rule 6.78-O(d)(1).

5 The Exchange is proposing that, for purposes of proposed Rule 1059, the term "authorized participant" would be defined as an entity that has a written agreement with the issuer of ETF shares or one of its service providers, which allows the authorized participant to place orders for the purchase and redemption of creation units (*i.e.*, specified numbers of ETF shares). While an authorized participant may be a member or member organization and directly effect transactions in options on the Exchange, an authorized participant that is not a member or member organization may effect transactions in options on the Exchange through a member or member organization on its behalf.

used to calculate the net asset value ("NAV") of such ETF shares. The NAV for ETF shares is represented by the traded price for ETFs holding options positions on days of creation or redemption, and an options pricing model on days in which creations and redemptions do not occur. This proposed new exception, although limited in scope, would have a significant impact in that it would help protect ETF shareholders from undesirable tax consequences and facilitate tax-efficient operations. The frequency with which ETFs and authorized participants would rely on the proposed exception would depend upon such factors as the number of ETFs holding options positions traded on the Exchange, the market demand for the shares of such ETFs, the redemption activity of authorized participants, and the investment strategies employed by such ETFs.

As described in further detail below, while ETFs do not sell and redeem individual shares to and from investors, they do sell large blocks of their shares to, and redeem them from, authorized participants in conjunction with what is known as the ETF creation and redemption process. Under the proposed exception, ETFs that hold options listed on the Exchange would be permitted to effect creation and redemption transactions with authorized participants on an "in-kind" basis, which is the process that may generally be utilized by ETFs for other asset types. This ability would allow such ETFs to function as more tax-efficient investment vehicles to be benefit of investors that hold

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6 The Exchange is proposing that, for purposes of proposed Rule 1059, any issuer of ETF shares would be registered with the Commission as an open-end management investment company under the Investment Company Act of 1940 (the "1940 Act").

7 An ETF share is a share or other security traded on a national securities exchange and defined as an NMS stock, which includes interest in open-end management investment companies. See Commentary .06 to Rule 1009.

ETF shares. In addition, it may also result in transaction cost savings for the ETFs, which may be passed along to investors.

While the Exchange recognizes that, in general, the execution of options transactions on exchanges provides certain benefits, such as price discovery and transparency, based on the circumstances under which proposed Rule 1059 would apply, the Exchange does not believe that such benefits would be compromised. In this regard, as discussed more fully below, the Exchange notes that in conjunction with the creation and redemption process, positions would be transferred at a price(s) used to calculate the NAV of such ETF shares. In addition, although options positions would be transferred off of the Exchange, they would not be closed or "traded." Rather, they would reside in a different clearing account until closed in a trade on the Exchange or until they expire. Further, as discussed below, proposed Rule 1059 would be clearly delineated and limited in scope, given that the proposed exception would only apply to transfers of options effected in connection with the creation and redemption process.

The ETF Creation and Redemption Process[8]

Due to their ability to effect in-kind transfers with authorized participants in conjunction with the creation and redemption process described below, ETFs have the potential to be significantly more tax-efficient than other pooled investment products,

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8 The following summary of the ETF creation and redemption process is based largely on portions of the discussion set forth in Investment Company Act Release No. 33140 (June 28, 2018), 83 FR 37332 (July 31, 2018) (the "Proposed ETF Rule Release") in which the Commission proposed a new rule under the 1940 Act that would permit ETFs registered as open-end management investment companies that satisfy certain conditions to operate without the need to obtain an exemptive order. The proposed rule was adopted on September 25, 2019. See Investment Company Act Release No. 33646 (September 25, 2019).

such as mutual funds. ETFs issue shares that may be purchased or sold during the day in the secondary market at market-determined prices. Similar to other types of investment companies, ETFs invest their assets in accordance with their investment objectives and investment strategies, and ETF shares represent interests in an ETF's underlying assets. ETFs are, in certain respects, similar to mutual funds in that they continuously offer their shares for sale. In contrast to mutual funds, however, ETFs do not sell or redeem individual shares. Rather, through the creation and redemption process referenced above, authorized participants have contractual arrangements with an ETF and/or its service provider (e.g., its distributor) purchase and redeem shares directly from that ETF in large aggregations known as "creation units." In general terms, to purchase a creation unit of ETF shares from an ETF, in return for depositing a "basket" of securities and/or other assets identified by the ETF on a particular day, the authorized participant will receive a creation unit of ETF shares. The basket deposited by the authorized participant is generally expected to be representative of the ETF's portfolio[9] and, when combined with a cash balancing amount (i.e., generally an amount of cash intended to account for any difference between the value of the basket and the NAV of a creation unit), if any, will be equal in value to the aggregate NAV of the shares of the ETF comprising the creation unit. After purchasing a creation unit, an authorized participant may then hold individual shares of the ETF and/or sell them in the secondary market. In connection with effecting redemptions, the creation process described above is reversed. More specifically, the

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9 Under certain circumstances, however, and subject to the provisions of its exemptive relief from various provisions of the 1940 Act obtained from the Commission, an ETF may substitute cash and/or other instruments in lieu of some or all of the ETF's portfolio holdings. For example, today, positions in options traded on the Exchange would be generally substituted with cash.

authorized participant will redeem a creation unit of ETF shares to the ETF in return for a basket of securities and/or other assets (along with any cash balancing account).

The ETF creation and redemption process, coupled with the secondary market trading of ETF shares, facilitates arbitrage opportunities that are intended to help keep the market price of ETF shares at or close to the NAV per share of the ETF. Authorized participants play an important role because of their ability, in general terms, to add ETF shares to, or remove them from, the market. In this regard, if shares of an ETF are trading at a discount (i.e., below NAV per share), an authorized participant may purchase ETF shares in the secondary market, accumulate enough shares for a creation unit and then redeem them from the ETF in exchange for the ETF's more valuable redemption basket. Accordingly, the authorized participant will profit because it paid less for the ETF shares than it received for the underlying assets. The reduction in the supply of ETF shares available on the secondary market, together with the sale of the ETF's basket assets, may cause the price of ETF shares to increase, the price of the basket assets to decrease, or both, thereby causing the market price of the ETF shares and the value of the ETF's holdings to move closer together. In contrast, if the ETF shares are trading at a premium (i.e., above NAV per share), the transactions are reversed (and the authorized participant would deliver the creation basket in exchange for ETF shares), resulting in an increase in the supply of ETF shares which may also help to keep the price of the shares of an ETF close to the value of its holdings.

In comparison to other pooled investment vehicles, one of the significant benefits associated with an ETF's in-kind redemption feature is tax efficiency. In this regard, by effecting redemptions on an in-kind basis (i.e., delivering certain assets from the ETF's

portfolio instead of cash), there is no need for the ETF to sell assets and potentially realize capital gains that would be distributed to shareholders. As indicated above, however, because Exchange Rules currently do not allow ETFs to effect in-kind transfers of options off of the Exchange, ETFs that invest in options traded on the Exchange are generally required to substitute cash in lieu of such options when effecting redemption transactions with authorized participants. Because they must sell the options to obtain the requisite cash, such ETFs (and therefore, investors that hold shares of those ETFs) are not able to benefit from the tax efficiencies afforded by in-kind transactions.

An additional benefit associated with the in-kind feature is the potential for transaction cost savings. In this regard, by transacting on an in-kind basis, ETFs may avoid certain transaction costs they would otherwise incur in connection with purchases and sales of securities and other assets. Again, however, this benefit is not available today to ETFs with respect to their options holdings.

Proposal

The Exchange notes that the Commission approved Rule 1058 in 2011 because the Exchange recognized, and the Commission agreed, that under certain circumstances, off-Exchange transfers were justified.[10] The Exchange believes that it is appropriate to permit off-Exchange transfers of options positions in connection with the creation and redemption process and recognizes that the prevalence and popularity of ETFs have increased greatly since the adoption of Rule 1058. Currently, ETFs serve both as popular

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10 See Securities Exchange Act Release No. 66023 (December 21, 2011), 76 FR 81553 (December 28, 2011) (SR-Phlx-2011-118).

investment vehicles and trading tools[11] and, as discussed above, the creation and redemption process, along with the arbitrage opportunities that accompany it, are key ETF features. Accordingly, the Exchange believes that providing for an additional, narrow circumstance to make it possible for ETFs that invest in options to effect creations and redemptions on an in-kind basis is justified.

The Exchange submits that its proposal is clearly delineated and limited in scope and not intended to facilitate "trading" options off of the Exchange. In this regard, the proposed circumstance would be available solely in the context of transfers of options positions effected in connection with transactions to purchase or redeem creation units of ETF shares between ETFs and authorized participants.[12] As a result of this process, such transfers would occur at the price(s) used to calculate the NAV of such ETF shares (as discussed above), which removes the need for price discovery on an Exchange for pricing these transfers. Moreover, as described above, ETFs and authorized participants are not seeking to effect the opening or closing of new options positions in connection with the

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11 As noted in the Proposed ETF Rule Release, during the first quarter of 2018, trading in U.S.-listed ETFs comprised approximately 18.75% of U.S. equity trading by share volume and 28.2% of U.S. equity trading by dollar volume (based on trade and quote data from the New York Stock Exchange and Trade Reporting Facility data from the Financial Industry Regulatory Authority, Inc. (FINRA)). See Proposed ETF Rule Release at 83 FR 37334.

12 See supra note 5. The term "authorized participant" is specific and narrowly defined. As noted in the Proposed ETF Rule Release, the requirement that only authorized participants of an ETF may purchase creation units from (or sell creation units to) an ETF "is designed to preserve an orderly creation unit issuance and redemption process between ETFs and authorized participants." Furthermore, an "orderly creation unit issuance and redemption process is of central importance to the arbitrage mechanism." See Proposed ETF Rule Release at 83 FR 37348.

creation and redemption process. Rather, the options positions would reside in a different clearing account until closed in a trade on the Exchange or until they expire.

The proposed transfers, while occurring between two different parties, will occur off the Exchange and will not be considered transactions (as is the case for current off-Exchange transfers permitted by Rule 1058(a)). While the prices of options transactions effected on the Exchange are disseminated to OPRA, back-office transfers of options positions in clearing accounts held at The Options Clearing Corporation ("OCC") (in accordance with OCC Rules)[13] are not disseminated to OPRA or otherwise publicly available, as they are considered position transfers, rather than executions.[14] The Exchange believes that price transparency is important in the options markets. However, the Exchange expects any transfers pursuant to the proposed rule will constitute a minimal percentage of the total average daily volume of the combined standardized and FLEX options[15] with the same underlying security or index.[16] Today, the trading of ETFs that invest in options is substantially limited on the Exchange, primarily because the current rules do not permit ETFs to effect in-kind transfers of options off the Exchange.

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13 OCC has informed the Exchange that it has the operational capabilities to effect the proposed position transfers. All transfers pursuant to proposed Rule 1059 would be required to comply with OCC rules. See Rules 1000(b)(3) and 1046 (which, taken together, requires all members and member organizations that are OCC members to comply with OCC's rules).

14 For example, any transfers effected pursuant to the current limited circumstances specified in Rule 1058(a) are not disseminated to OPRA.

15 See Options 8, Section 34 for FLEX options provisions.

16 The Exchange notes that the price discovery process in standardized options contracts in a particular class of options generally provides meaningful guideposts for pricing FLEX options with the same underlying security or index.

The Exchange continues to expect that any impact this proposal could have on price transparency in the options market is minimal because the proposed rule change is limited in scope, and is intended to provide market participants with an efficient and effective means to transfer options positions under clearly delineated, specified circumstances. Additionally, as noted above, the NAV for transfers will generally be based on the disseminated closing price for an options series on the day of a creation or redemption, and thus the price (although not the time or quantity of the transfer) at which these transfers will generally be effected will be publicly available.[17] Further, the Exchange generally expects creations or redemptions to include corresponding transactions by the authorized participant that will occur on an exchange and be reported to OPRA.[18] Therefore, the Exchange expects that any impact the proposed rule change could have on price transparency in the options market would be de minimis.

Other than the transfers covered by the proposed rule, transactions involving options, whether held by an ETF or an authorized participant, would be fully subject to

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17 If there is no disseminated closing price, the ETF would price according to a pricing model or procedure as described in the fund's prospectus.

18 The Exchange notes that for in-kind creations, an authorized participant will acquire the necessary options positions in an on-exchange transaction that will be reported to OPRA. For in-kind redemptions, the Exchange generally expects that an authorized participant will acquire both the shares necessary to effect the redemption and an options position to offset the position that it will receive as proceeds for the redemption. Such an options position would likely be acquired in an on-exchange transaction that would be reported to OPRA. Such transactions are generally identical to the way that creations and redemptions work for equities and fixed income transactions – while the transfer between the authorized participant and the fund is not necessarily reported, there are generally corresponding transactions that would be reported, providing transparency into the transactions.

all applicable trading Rules.[19] Accordingly, the Exchange does not believe that the proposed new exception would compromise price discovery or transparency.

Further, the Exchange believes that providing an additional exception to make it possible for ETFs that invest in options to effect creations and redemptions on an in-kind basis is justified because, while the proposed exception would be limited in scope, the benefits that may flow to ETFs that hold options and their investors may be significant. Specifically, the Exchange expects such ETFs and their investors would benefit from increased tax efficiencies and potential transaction cost savings. By making such ETFs more attractive to both current and prospective investors, the proposed rule change would enable them to compete more effectively with other ETFs that, due to their particular portfolio holdings, may effect in-kind creations and redemptions without restriction.

b. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,[20] in general, and furthers the objectives of Section 6(b)(5) of the Act,[21] 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, in general to protect investors and the public interest.

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19 As indicated above, the operation of the arbitrage mechanism accompanying the creation and redemption process generally contemplates ongoing interactions between authorized participants and the market in transactions involving both ETF shares and the assets comprising an ETF's creation/redemption basket.

20 15 U.S.C. 78f(b).

21 15 U.S.C. 78f(b)(5).

The Exchange believes that permitting off-Exchange transfers in connection with the in-kind ETF creation and redemption process promotes just and equitable principles of trade and helps remove impediments to and perfect the mechanism of a free and open market and a national market system, as it would permit ETFs that invest in options traded on the Exchange to utilize the in-kind creation and redemption process that is available for ETFs that invest in equities and fixed-income securities. This process represents a significant feature of the ETF structure generally, with advantages that distinguish ETFs from other types of pooled investment vehicles. In light of the associated tax efficiencies and potential transaction cost savings, the Exchange believes the ability to utilize an in-kind process would make such ETFs more attractive to both current and prospective investors and enable them to compete more effectively with other ETFs that, based on their portfolio holdings, may effect in-kind creations and redemptions without restriction. In addition, the Exchange believes that because it would permit ETFs that invest in options traded on the Exchange to benefit from tax efficiencies and potential transaction cost savings afforded by the in-kind creation and redemption process, which benefits the Exchange expects would generally be passed along to investors that hold ETF shares, the proposed rule change would protect investors and the public interest.

Moreover, the Exchange submits that the proposed exception is clearly delineated and limited in scope and not intended to facilitate "trading" options off the Exchange. Other than the transfers covered by the proposed exception, transactions involving options, whether held by an ETF or an authorized participant, would be fully subject to the applicable trading Rules. Additionally, the transfers covered by the proposed

exception would occur at a price(s) used to calculate the NAV of the applicable ETF shares, which removes the need for price discovery on the Exchange. Accordingly, the Exchange does not believe that the proposed rule change would compromise price discovery or transparency.

When Congress charged the Commission with supervising the development of a "national market system" for securities, Congress stated its intent that the "national market system evolve through the interplay of competitive forces as unnecessary regulatory restrictions are removed."[22] Consistent with this purpose, Congress and the Commission have repeatedly stated their preference for competition, rather than regulatory intervention to determine products and services in the securities markets.[23] This consistent and considered judgment of Congress and the Commission is correct, particularly in light of evidence of robust competition among exchanges. The fact that an exchange proposed something new is a reason to be receptive, not skeptical — innovation is the life-blood of a vibrant competitive market — and that is particularly so given the

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22 See H.R. Rep. 94-229, at 92 (1975) (Conf. Rep.).

23 See S. Rep. No. 94-75, 94th Cong., 1st Sess. 8 (1975) ("The objective [in enacting the 1975 amendments to the Exchange Act] would be to enhance competition and to allow economic forces, interacting within a fair regulatory field, to arrive at appropriate variations in practices and services."); Order Approving Proposed Rule Change Relating to NYSE Arca Data, Securities Exchange Act Release No. 59039 (December 2, 2008), 73 FR 74770 (December 9, 2008) ("The Exchange Act and its legislative history strongly support the Commission's reliance on competition, whenever possible, in meeting its regulatory responsibilities for overseeing the [self-regulatory organizations] and the national market system. Indeed, competition among multiple markets and market participants trading the same products is the hallmark of the national market system."); and Regulation NMS, 70 FR at 37499 (observing that NMS regulation "has been remarkably successful in promoting market competition in [the] forms that are most important to investors and listed companies").

continued internalization of the securities markets, as exchanges continue to implement new products and services to compete not only in the United States but throughout the world. Exchanges continuously adopt new and different products and trading services in response to industry demands in order to attract order flow and liquidity to increase their trading volume. This competition has led to a growth in investment choices, which ultimately benefits the marketplace and the public.

Currently, the Exchange Rules do not allow ETFs to effect in-kind transfers of options off of the Exchange, resulting in tax inefficiencies for ETFs that hold them. As a result, the use of options by ETFs is substantially limited. While the proposed exception would be limited in scope, the Exchange believes the benefits that may flow to ETFs that hold options and their investors may be significant. Specifically, the Exchange expects that such ETFs and their investors could benefit from increased tax efficiencies and potential transaction cost savings. By making such ETFs more attractive to both current and prospective investors, the proposed rule change would enable them to compete more effectively with other ETFs that, due to their particular portfolio holdings, may effect in-kind creations and redemptions without restriction. This may lead to further development of ETFs that invest in options, thereby fostering competition and resulting in additional choices for investors, which ultimately benefits the marketplace and the public.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange does not believe the proposed rule change will impose any burden on intramarket competition that is not necessary or appropriate in furtherance of the purposes of the Act. Utilizing the proposed exception would be voluntary. As an

alternative to the normal auction process, the proposed rule change would provide market participants with an efficient and effective means to transfer positions under the specified circumstances. The proposed exception would enable all ETFs that hold options to enjoy the benefits of in-kind creations and redemptions already available to other ETFs (and to pass these benefits along to investors). The proposed rule change would apply in the same manner to all entities that meet the definition of "authorized participant."

The Exchange does not believe the proposed rule change will impose any burden on intermarket competition that is not necessary or appropriate in furtherance of the purposes of the Act. As indicated above, it is intended to provide an additional clearly delineated and limited circumstance in which options positions can be transferred off an exchange. Further, the Exchange believes the proposed rule change will eliminate a significant competitive disadvantage for ETFs that invest in options. Furthermore, as indicated above, in light of the significant benefits provided (e.g., tax efficiencies and potential transaction cost savings), the proposed exception may lead to further development of ETFs that invest in options, thereby fostering competition and resulting in additional choices for investors, which ultimately benefits the marketplace and the public. Lastly, the Exchange notes that proposed rule change is based on a recent Cboe rule change approved by the Commission.[24] As such, the Exchange believes that its proposal enhances fair competition between markets by providing for additional listing venues for ETFs that hold options to utilize the in-kind transfers proposed herein.

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[24] See supra note 3.

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)

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)(iii)[25] of the Act and Rule 19b-4(f)(6) thereunder[26] in that it effects a change that: (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) by its terms, does not become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest.

The Exchange believes that the proposed rule change is consistent with the public interest and the protection of investors, and will not impose any significant burden on competition, because the proposed rule, which is similar to Cboe Rule 6.9, will provide an additional clearly delineated and limited circumstance in which options positions can be transferred off an exchange, which the Exchange believes will eliminate a significant competitive disadvantage for ETFs that invest in options. Furthermore, in light of the significant benefits provided (e.g., tax efficiencies and potential transaction cost savings), the proposed exception may lead to further development of ETFs that invest in options,

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25 15 U.S.C. 78s(b)(3)(A)(iii).

26 17 CFR 240.19b-4(f)(6).

thereby fostering competition and resulting in additional choices for investors, which ultimately benefits the market place and the public. Moreover, the proposed rule change is substantially similar in all material respects to Cboe's Rule 6.9, and therefore does not raise any novel regulatory issues.[27] As such, the Exchange believes that its proposal qualifies for immediate effectiveness as a "non-controversial" rule change under Rule 19b-4(f)(6).

Furthermore, Rule 19b-4(f)(6)(iii)[28] requires a self-regulatory organization to give the Commission written notice of its intent to file a proposed rule change under that subsection at least five business days prior to the date of filing, or such shorter time as designated by the Commission. The Exchange has provided such notice.

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative prior to 30 days after the date of filing. Rule 19b-4(f)(6)(iii), however, permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange requests that the Commission waive the 30-day operative delay contained in Rule 19b-4(f)(6)(iii). Waiver of the operative

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27 See supra note 3.

28 17 CFR 240.19b-4(f)(6)(iii).

delay is consistent with the protection of investors and the public interest because it will ensure fair competition among options exchanges by allowing the Exchange to adopt a transfer rule similar to Cboe Rule 6.9 as soon as possible. The Exchange believes that adopting this rule will benefit investors and the general public because of the significant benefits provided (e.g., tax efficiencies and potential transaction cost savings) as discussed above, which may lead to further development of ETFs that invest in options, thereby fostering competition and resulting in additional choices for investors.

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

The proposed rule change is similar to SR-CBOE-2019-048.[29] Unlike Cboe, the Exchange's proposed rule does not have a general prohibition on off-Exchange transfers of options positions.

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 Change for publication in the Federal Register.

5. Text of the proposed rule change.

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[29] See supra note 3.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. ; File No. SR-Phlx-2019-53)

December __, 2019

Self-Regulatory Organizations; Nasdaq PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Adopt a New Rule 1059

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on December 4, 2019, 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 adopt a new Rule 1059 titled "In-Kind Exchange of Options Positions and ETF Shares."

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.

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

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

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 Exchange proposes to adopt a new Rule 1059 titled "In-Kind Exchange of Options Positions and ETF Shares," based on recent changes proposed by Cboe Exchange, Inc. ("Cboe") and approved by the Commission.[3]

Background

As discussed further below, the ability to effect "in kind" transfers is a key component of the operational structure of an exchange-traded fund ("ETF"). Currently, in general, ETFs can effect in-kind transfers with respect to equity securities and fixed-income securities. The in-kind process is a major benefit to ETF shareholders and, in general, the means by which assets may be added to or removed from ETFs. In-kind transfers protect ETF shareholders from the undesirable tax effects of frequent "creations and redemptions" (described below) and improve the overall tax efficiency of the products. However, currently, the Exchange Rules do not provide for ETFs to effect in-kind transfers of options off of the Exchange, resulting in tax inefficiencies for ETFs that hold them. As a result, the use of options by ETFs is substantially limited.

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[3] See Cboe Rule 6.9. See also Securities Exchange Act Release No. 87340 (October 17, 2019) (SR-CBOE-2019-048) (Order Approving on an Accelerated Basis a Proposed Rule Change, as Modified by Amendment Nos. 2 and 3, to Adopt Rule 6.9 (In-Kind Exchange of Options Positions and ETF Shares)).

Currently, Rule 1058(a) permits members or member organizations to transfer their positions off of the Exchange in specified, limited circumstances. The circumstances currently listed include: (1) the dissolution of a joint account in which the remaining member or member organization assumes the positions of the joint account; (2) the dissolution of a corporation or partnership in which a former nominee of that corporation or partnership assumes the positions; (3) positions transferred as part of a member or member organization's capital contribution to a new joint account, partnership, or corporation; (4) the donation of positions to a not-for-profit corporation; (5) the transfer of positions to a minor under the Uniform Gifts to Minors Act; (6) a merger or acquisition resulting in a continuity of ownership or management; and (7) consolidation of accounts within a member or member organization.[4] At present, the list of limited circumstances in Rule 1058(a) that allows members to transfer their options positions off the Exchange does not include an exception for in-kind transfers.

The Exchange proposes to add a new circumstance under which off-Exchange transfers of options positions would be permitted to occur. Specifically, under proposed Rule 1059, positions in options listed on the Exchange would be permitted to be transferred off the Exchange by a member or member organization in connection with transactions to purchase or redeem "creation units" of ETF shares between an "authorized participant"[5] and the issuer[6] of such ETF shares,[7] which transfers would occur at the price

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4 The Exchange notes that other options exchanges have adopted rules that provide for off-Exchange transfers under similar circumstances. See, e.g., Cboe Rule 6.7(a); and NYSE Arca, Inc. Rule 6.78-O(d)(1).

5 The Exchange is proposing that, for purposes of proposed Rule 1059, the term "authorized participant" would be defined as an entity that has a written agreement with the issuer of ETF shares or one of its service providers, which allows the authorized participant to place orders for the purchase and redemption

used to calculate the net asset value ("NAV") of such ETF shares. The NAV for ETF shares is represented by the traded price for ETFs holding options positions on days of creation or redemption, and an options pricing model on days in which creations and redemptions do not occur. This proposed new exception, although limited in scope, would have a significant impact in that it would help protect ETF shareholders from undesirable tax consequences and facilitate tax-efficient operations. The frequency with which ETFs and authorized participants would rely on the proposed exception would depend upon such factors as the number of ETFs holding options positions traded on the Exchange, the market demand for the shares of such ETFs, the redemption activity of authorized participants, and the investment strategies employed by such ETFs.

As described in further detail below, while ETFs do not sell and redeem individual shares to and from investors, they do sell large blocks of their shares to, and redeem them from, authorized participants in conjunction with what is known as the ETF creation and redemption process. Under the proposed exception, ETFs that hold options listed on the Exchange would be permitted to effect creation and redemption transactions with authorized participants on an "in-kind" basis, which is the process that may

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of creation units (*i.e.*, specified numbers of ETF shares). While an authorized participant may be a member or member organization and directly effect transactions in options on the Exchange, an authorized participant that is not a member or member organization may effect transactions in options on the Exchange through a member or member organization on its behalf.

6 The Exchange is proposing that, for purposes of proposed Rule 1059, any issuer of ETF shares would be registered with the Commission as an open-end management investment company under the Investment Company Act of 1940 (the "1940 Act").

7 An ETF share is a share or other security traded on a national securities exchange and defined as an NMS stock, which includes interest in open-end management investment companies. See Commentary .06 to Rule 1009.

generally be utilized by ETFs for other asset types. This ability would allow such ETFs to function as more tax-efficient investment vehicles to be benefit of investors that hold ETF shares. In addition, it may also result in transaction cost savings for the ETFs, which may be passed along to investors.

While the Exchange recognizes that, in general, the execution of options transactions on exchanges provides certain benefits, such as price discovery and transparency, based on the circumstances under which proposed Rule 1059 would apply, the Exchange does not believe that such benefits would be compromised. In this regard, as discussed more fully below, the Exchange notes that in conjunction with the creation and redemption process, positions would be transferred at a price(s) used to calculate the NAV of such ETF shares. In addition, although options positions would be transferred off of the Exchange, they would not be closed or "traded." Rather, they would reside in a different clearing account until closed in a trade on the Exchange or until they expire. Further, as discussed below, proposed Rule 1059 would be clearly delineated and limited in scope, given that the proposed exception would only apply to transfers of options effected in connection with the creation and redemption process.

The ETF Creation and Redemption Process[8]

Due to their ability to effect in-kind transfers with authorized participants in conjunction with the creation and redemption process described below, ETFs have the

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8 The following summary of the ETF creation and redemption process is based largely on portions of the discussion set forth in Investment Company Act Release No. 33140 (June 28, 2018), 83 FR 37332 (July 31, 2018) (the "Proposed ETF Rule Release") in which the Commission proposed a new rule under the 1940 Act that would permit ETFs registered as open-end management investment companies that satisfy certain conditions to operate without the need to obtain an exemptive order. The proposed rule was adopted on September 25, 2019. See Investment Company Act Release No. 33646 (September 25, 2019).

potential to be significantly more tax-efficient than other pooled investment products, such as mutual funds. ETFs issue shares that may be purchased or sold during the day in the secondary market at market-determined prices. Similar to other types of investment companies, ETFs invest their assets in accordance with their investment objectives and investment strategies, and ETF shares represent interests in an ETF's underlying assets. ETFs are, in certain respects, similar to mutual funds in that they continuously offer their shares for sale. In contrast to mutual funds, however, ETFs do not sell or redeem individual shares. Rather, through the creation and redemption process referenced above, authorized participants have contractual arrangements with an ETF and/or its service provider (e.g., its distributor) purchase and redeem shares directly from that ETF in large aggregations known as "creation units." In general terms, to purchase a creation unit of ETF shares from an ETF, in return for depositing a "basket" of securities and/or other assets identified by the ETF on a particular day, the authorized participant will receive a creation unit of ETF shares. The basket deposited by the authorized participant is generally expected to be representative of the ETF's portfolio[9] and, when combined with a cash balancing amount (i.e., generally an amount of cash intended to account for any difference between the value of the basket and the NAV of a creation unit), if any, will be equal in value to the aggregate NAV of the shares of the ETF comprising the creation unit. After purchasing a creation unit, an authorized participant may then hold individual shares of the ETF and/or sell them in the secondary market. In connection with effecting

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9 Under certain circumstances, however, and subject to the provisions of its exemptive relief from various provisions of the 1940 Act obtained from the Commission, an ETF may substitute cash and/or other instruments in lieu of some or all of the ETF's portfolio holdings. For example, today, positions in options traded on the Exchange would be generally substituted with cash.

redemptions, the creation process described above is reversed. More specifically, the authorized participant will redeem a creation unit of ETF shares to the ETF in return for a basket of securities and/or other assets (along with any cash balancing account).

The ETF creation and redemption process, coupled with the secondary market trading of ETF shares, facilitates arbitrage opportunities that are intended to help keep the market price of ETF shares at or close to the NAV per share of the ETF. Authorized participants play an important role because of their ability, in general terms, to add ETF shares to, or remove them from, the market. In this regard, if shares of an ETF are trading at a discount (i.e., below NAV per share), an authorized participant may purchase ETF shares in the secondary market, accumulate enough shares for a creation unit and then redeem them from the ETF in exchange for the ETF's more valuable redemption basket. Accordingly, the authorized participant will profit because it paid less for the ETF shares than it received for the underlying assets. The reduction in the supply of ETF shares available on the secondary market, together with the sale of the ETF's basket assets, may cause the price of ETF shares to increase, the price of the basket assets to decrease, or both, thereby causing the market price of the ETF shares and the value of the ETF's holdings to move closer together. In contrast, if the ETF shares are trading at a premium (i.e., above NAV per share), the transactions are reversed (and the authorized participant would deliver the creation basket in exchange for ETF shares), resulting in an increase in the supply of ETF shares which may also help to keep the price of the shares of an ETF close to the value of its holdings.

In comparison to other pooled investment vehicles, one of the significant benefits associated with an ETF's in-kind redemption feature is tax efficiency. In this regard, by

effecting redemptions on an in-kind basis (i.e., delivering certain assets from the ETF's portfolio instead of cash), there is no need for the ETF to sell assets and potentially realize capital gains that would be distributed to shareholders. As indicated above, however, because Exchange Rules currently do not allow ETFs to effect in-kind transfers of options off of the Exchange, ETFs that invest in options traded on the Exchange are generally required to substitute cash in lieu of such options when effecting redemption transactions with authorized participants. Because they must sell the options to obtain the requisite cash, such ETFs (and therefore, investors that hold shares of those ETFs) are not able to benefit from the tax efficiencies afforded by in-kind transactions.

An additional benefit associated with the in-kind feature is the potential for transaction cost savings. In this regard, by transacting on an in-kind basis, ETFs may avoid certain transaction costs they would otherwise incur in connection with purchases and sales of securities and other assets. Again, however, this benefit is not available today to ETFs with respect to their options holdings.

Proposal

The Exchange notes that the Commission approved Rule 1058 in 2011 because the Exchange recognized, and the Commission agreed, that under certain circumstances, off-Exchange transfers were justified.[10] The Exchange believes that it is appropriate to permit off-Exchange transfers of options positions in connection with the creation and redemption process and recognizes that the prevalence and popularity of ETFs have increased greatly since the adoption of Rule 1058. Currently, ETFs serve both as popular

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10 See Securities Exchange Act Release No. 66023 (December 21, 2011), 76 FR 81553 (December 28, 2011) (SR-Phlx-2011-118).

investment vehicles and trading tools[11] and, as discussed above, the creation and redemption process, along with the arbitrage opportunities that accompany it, are key ETF features. Accordingly, the Exchange believes that providing for an additional, narrow circumstance to make it possible for ETFs that invest in options to effect creations and redemptions on an in-kind basis is justified.

The Exchange submits that its proposal is clearly delineated and limited in scope and not intended to facilitate "trading" options off of the Exchange. In this regard, the proposed circumstance would be available solely in the context of transfers of options positions effected in connection with transactions to purchase or redeem creation units of ETF shares between ETFs and authorized participants.[12] As a result of this process, such transfers would occur at the price(s) used to calculate the NAV of such ETF shares (as discussed above), which removes the need for price discovery on an Exchange for pricing these transfers. Moreover, as described above, ETFs and authorized participants are not seeking to effect the opening or closing of new options positions in connection with the

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11 As noted in the Proposed ETF Rule Release, during the first quarter of 2018, trading in U.S.-listed ETFs comprised approximately 18.75% of U.S. equity trading by share volume and 28.2% of U.S. equity trading by dollar volume (based on trade and quote data from the New York Stock Exchange and Trade Reporting Facility data from the Financial Industry Regulatory Authority, Inc. (FINRA)). See Proposed ETF Rule Release at 83 FR 37334.

12 See supra note 5. The term "authorized participant" is specific and narrowly defined. As noted in the Proposed ETF Rule Release, the requirement that only authorized participants of an ETF may purchase creation units from (or sell creation units to) an ETF "is designed to preserve an orderly creation unit issuance and redemption process between ETFs and authorized participants." Furthermore, an "orderly creation unit issuance and redemption process is of central importance to the arbitrage mechanism." See Proposed ETF Rule Release at 83 FR 37348.

creation and redemption process. Rather, the options positions would reside in a different clearing account until closed in a trade on the Exchange or until they expire.

The proposed transfers, while occurring between two different parties, will occur off the Exchange and will not be considered transactions (as is the case for current off-Exchange transfers permitted by Rule 1058(a)). While the prices of options transactions effected on the Exchange are disseminated to OPRA, back-office transfers of options positions in clearing accounts held at The Options Clearing Corporation ("OCC") (in accordance with OCC Rules)[13] are not disseminated to OPRA or otherwise publicly available, as they are considered position transfers, rather than executions.[14] The Exchange believes that price transparency is important in the options markets. However, the Exchange expects any transfers pursuant to the proposed rule will constitute a minimal percentage of the total average daily volume of the combined standardized and FLEX options[15] with the same underlying security or index.[16] Today, the trading of ETFs that invest in options is substantially limited on the Exchange, primarily because the current rules do not permit ETFs to effect in-kind transfers of options off the Exchange. The Exchange continues to expect that any impact this proposal could have on price

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13 OCC has informed the Exchange that it has the operational capabilities to effect the proposed position transfers. All transfers pursuant to proposed Rule 1059 would be required to comply with OCC rules. See Rules 1000(b)(3) and 1046 (which, taken together, requires all members and member organizations that are OCC members to comply with OCC's rules).

14 For example, any transfers effected pursuant to the current limited circumstances specified in Rule 1058(a) are not disseminated to OPRA.

15 See Options 8, Section 34 for FLEX options provisions.

16 The Exchange notes that the price discovery process in standardized options contracts in a particular class of options generally provides meaningful guideposts for pricing FLEX options with the same underlying security or index.

transparency in the options market is minimal because the proposed rule change is limited in scope, and is intended to provide market participants with an efficient and effective means to transfer options positions under clearly delineated, specified circumstances. Additionally, as noted above, the NAV for transfers will generally be based on the disseminated closing price for an options series on the day of a creation or redemption, and thus the price (although not the time or quantity of the transfer) at which these transfers will generally be effected will be publicly available.[17] Further, the Exchange generally expects creations or redemptions to include corresponding transactions by the authorized participant that will occur on an exchange and be reported to OPRA.[18] Therefore, the Exchange expects that any impact the proposed rule change could have on price transparency in the options market would be de minimis.

Other than the transfers covered by the proposed rule, transactions involving options, whether held by an ETF or an authorized participant, would be fully subject to

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17 If there is no disseminated closing price, the ETF would price according to a pricing model or procedure as described in the fund's prospectus.

18 The Exchange notes that for in-kind creations, an authorized participant will acquire the necessary options positions in an on-exchange transaction that will be reported to OPRA. For in-kind redemptions, the Exchange generally expects that an authorized participant will acquire both the shares necessary to effect the redemption and an options position to offset the position that it will receive as proceeds for the redemption. Such an options position would likely be acquired in an on-exchange transaction that would be reported to OPRA. Such transactions are generally identical to the way that creations and redemptions work for equities and fixed income transactions – while the transfer between the authorized participant and the fund is not necessarily reported, there are generally corresponding transactions that would be reported, providing transparency into the transactions.

all applicable trading Rules.[19] Accordingly, the Exchange does not believe that the proposed new exception would compromise price discovery or transparency.

Further, the Exchange believes that providing an additional exception to make it possible for ETFs that invest in options to effect creations and redemptions on an in-kind basis is justified because, while the proposed exception would be limited in scope, the benefits that may flow to ETFs that hold options and their investors may be significant. Specifically, the Exchange expects such ETFs and their investors would benefit from increased tax efficiencies and potential transaction cost savings. By making such ETFs more attractive to both current and prospective investors, the proposed rule change would enable them to compete more effectively with other ETFs that, due to their particular portfolio holdings, may effect in-kind creations and redemptions without restriction.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,[20] in general, and furthers the objectives of Section 6(b)(5) of the Act,[21] 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, in general to protect investors and the public interest.

The Exchange believes that permitting off-Exchange transfers in connection with the in-kind ETF creation and redemption process promotes just and equitable principles

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19 As indicated above, the operation of the arbitrage mechanism accompanying the creation and redemption process generally contemplates ongoing interactions between authorized participants and the market in transactions involving both ETF shares and the assets comprising an ETF's creation/redemption basket.

20 15 U.S.C. 78f(b).

21 15 U.S.C. 78f(b)(5).

of trade and helps remove impediments to and perfect the mechanism of a free and open market and a national market system, as it would permit ETFs that invest in options traded on the Exchange to utilize the in-kind creation and redemption process that is available for ETFs that invest in equities and fixed-income securities. This process represents a significant feature of the ETF structure generally, with advantages that distinguish ETFs from other types of pooled investment vehicles. In light of the associated tax efficiencies and potential transaction cost savings, the Exchange believes the ability to utilize an in-kind process would make such ETFs more attractive to both current and prospective investors and enable them to compete more effectively with other ETFs that, based on their portfolio holdings, may effect in-kind creations and redemptions without restriction. In addition, the Exchange believes that because it would permit ETFs that invest in options traded on the Exchange to benefit from tax efficiencies and potential transaction cost savings afforded by the in-kind creation and redemption process, which benefits the Exchange expects would generally be passed along to investors that hold ETF shares, the proposed rule change would protect investors and the public interest.

Moreover, the Exchange submits that the proposed exception is clearly delineated and limited in scope and not intended to facilitate "trading" options off the Exchange. Other than the transfers covered by the proposed exception, transactions involving options, whether held by an ETF or an authorized participant, would be fully subject to the applicable trading Rules. Additionally, the transfers covered by the proposed exception would occur at a price(s) used to calculate the NAV of the applicable ETF shares, which removes the need for price discovery on the Exchange. Accordingly, the

Exchange does not believe that the proposed rule change would compromise price discovery or transparency.

When Congress charged the Commission with supervising the development of a "national market system" for securities, Congress stated its intent that the "national market system evolve through the interplay of competitive forces as unnecessary regulatory restrictions are removed."[22] Consistent with this purpose, Congress and the Commission have repeatedly stated their preference for competition, rather than regulatory intervention to determine products and services in the securities markets.[23] This consistent and considered judgment of Congress and the Commission is correct, particularly in light of evidence of robust competition among exchanges. The fact that an exchange proposed something new is a reason to be receptive, not skeptical — innovation is the life-blood of a vibrant competitive market — and that is particularly so given the continued internalization of the securities markets, as exchanges continue to implement new products and services to compete not only in the United States but throughout the world. Exchanges continuously adopt new and different products and trading services in

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22 See H.R. Rep. 94-229, at 92 (1975) (Conf. Rep.).

23 See S. Rep. No. 94-75, 94th Cong., 1st Sess. 8 (1975) ("The objective [in enacting the 1975 amendments to the Exchange Act] would be to enhance competition and to allow economic forces, interacting within a fair regulatory field, to arrive at appropriate variations in practices and services."); Order Approving Proposed Rule Change Relating to NYSE Arca Data, Securities Exchange Act Release No. 59039 (December 2, 2008), 73 FR 74770 (December 9, 2008) ("The Exchange Act and its legislative history strongly support the Commission's reliance on competition, whenever possible, in meeting its regulatory responsibilities for overseeing the [self-regulatory organizations] and the national market system. Indeed, competition among multiple markets and market participants trading the same products is the hallmark of the national market system."); and Regulation NMS, 70 FR at 37499 (observing that NMS regulation "has been remarkably successful in promoting market competition in [the] forms that are most important to investors and listed companies").

response to industry demands in order to attract order flow and liquidity to increase their trading volume. This competition has led to a growth in investment choices, which ultimately benefits the marketplace and the public.

Currently, the Exchange Rules do not allow ETFs to effect in-kind transfers of options off of the Exchange, resulting in tax inefficiencies for ETFs that hold them. As a result, the use of options by ETFs is substantially limited. While the proposed exception would be limited in scope, the Exchange believes the benefits that may flow to ETFs that hold options and their investors may be significant. Specifically, the Exchange expects that such ETFs and their investors could benefit from increased tax efficiencies and potential transaction cost savings. By making such ETFs more attractive to both current and prospective investors, the proposed rule change would enable them to compete more effectively with other ETFs that, due to their particular portfolio holdings, may effect in-kind creations and redemptions without restriction. This may lead to further development of ETFs that invest in options, thereby fostering competition and resulting in additional choices for investors, which ultimately benefits the marketplace and the public.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange does not believe the proposed rule change will impose any burden on intramarket competition that is not necessary or appropriate in furtherance of the purposes of the Act. Utilizing the proposed exception would be voluntary. As an alternative to the normal auction process, the proposed rule change would provide market participants with an efficient and effective means to transfer positions under the specified circumstances. The proposed exception would enable all ETFs that hold options to enjoy

the benefits of in-kind creations and redemptions already available to other ETFs (and to pass these benefits along to investors). The proposed rule change would apply in the same manner to all entities that meet the definition of "authorized participant."

The Exchange does not believe the proposed rule change will impose any burden on intermarket competition that is not necessary or appropriate in furtherance of the purposes of the Act. As indicated above, it is intended to provide an additional clearly delineated and limited circumstance in which options positions can be transferred off an exchange. Further, the Exchange believes the proposed rule change will eliminate a significant competitive disadvantage for ETFs that invest in options. Furthermore, as indicated above, in light of the significant benefits provided (e.g., tax efficiencies and potential transaction cost savings), the proposed exception may lead to further development of ETFs that invest in options, thereby fostering competition and resulting in additional choices for investors, which ultimately benefits the marketplace and the public. Lastly, the Exchange notes that proposed rule change is based on a recent Cboe rule change approved by the Commission.[24] As such, the Exchange believes that its proposal enhances fair competition between markets by providing for additional listing venues for ETFs that hold options to utilize the in-kind transfers proposed herein.

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.

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[24] See supra note 3.

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A)(iii) of the Act[25] and subparagraph (f)(6) of Rule 19b-4 thereunder.[26]

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

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25 15 U.S.C. 78s(b)(3)(A)(iii).

26 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-Phlx-2019-53 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-Phlx-2019-53. 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-2019-53 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.[27]

Jill M. Peterson
Assistant Secretary

[27] 17 CFR 200.30-3(a)(12).

EXHIBIT 5

Deleted text is [bracketed]. New text is underlined.

Nasdaq PHLX Rules

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Rule 1059. In-Kind Exchange of Options Positions and ETF Shares

Positions in options listed on the Exchange may be transferred off the Exchange by a member or member organization in connection with transactions to purchase or redeem creation units of ETF shares between an authorized participant and the issuer of such ETF shares, which transfer would occur at the price(s) used to calculate the net asset value of such ETF shares. For purposes of this Rule:

(a) an "authorized participant" is an entity that has a written agreement with the issuer of ETF shares or one of its service providers, which allows the authorized participant to place orders for the purchase and redemption of creation units (*i.e.*, specified numbers of ETF shares); and

(b) an "issuer of ETF shares" is an entity registered with the Commission as an open-ended management investment company under the Investment Company Act of 1940.

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