



Summary Report¹ on STA Open Call held July 10, 2018
FINRA Cross Product Surveillance of the Listed Options & Equity Markets
Presenter: Gene DeMaio, Senior Vice President, FINRA

Opening Remarks & Introduction – Jim Toes

- STA recently met with the SEC & FINRA on a range of issues including: CAT; SEC Proposed Access Fee Pilot; Reg ATS-N and Proposed Amendments to Order Handling Rules. Talking Points are [here](#).
- Senate Banking Committee will hold a July 24th hearing on the nomination of Elad Roisman as SEC Commissioner. Mr. Roisman is the Republican nominee to replace Commissioner Piwowar. A Democratic nominee to replace Commissioner Stein, whose term expires Dec. 31, has not been identified yet.
- STA opened registration for its 85th Annual Market Structure Conference taking place Oct. 3-5 at the JW Marriott, Washington DC. We are planning the program, which will include Rep Bill Huizenga.
- On a previous STA Open Call, FINRA’s Tom Gira discussed FINRA’s capabilities in using Artificial Intelligence (AI) for its cross market and cross product surveillance. Tonight, Gene DeMaio is going to discuss FINRA’s regulatory priorities for the listed options market, which includes using AI in the surveillance of activity in the equity markets that originates from listed options participants.

Summary Remarks – Gene DeMaio, SVP FINRA Market Regulation

FINRA’s use of AI has enabled us to be more effective in areas where FINRA’s regulatory priorities have remained consistent. FINRA’s options-related priorities include:

Pre-Hedging/Front Running – These are situations where in the course of facilitating a customer order, the facilitating firm accumulates a position in the same security or another highly correlated security thereby impacting the price of the customer security potentially to the customer’s disadvantage.

Marking the Close – FINRA has found instances where firms that maintain an equity and options business only have policies and procedures for monitoring marking the close for the equity lines. FINRA recommends that firms have policies and procedures in place for both asset classes.

Partial Tender Offers – FINRA continues to see situations where Short Call Positions are not being calculated properly in partial tender offers. We continue to raise awareness on this issue.

“Mini-Manipulation” – AI has also enabled FINRA to surveil in new areas pertaining to the listed options market, which we refer to as “mini-manipulation.” Broadly speaking, these are situations whereby the underlying price of an equity security is manipulated with what is often a small order that affects the price of a listed option on that equity security enabling a position to either be established or liquidated at advantageous prices. Our surveillance protocol looks for specific scenarios whereby positions in the options are either established at advantageous prices and are unwound quickly or held long term after establishing the position at a favorable volatility level. Many of the situations we have seen involve large cap securities during quiet times in the market when there is less trading activity in the equity security. The behavior we have witnessed is generally executed through algorithms and is systemic as opposed to manual and one-off’s.

¹ This brief is meant for informational purposes only and therefore should not be considered legal advice. STA’s goal is to raise awareness on industry developments and encourage dialogue.