



September 24, 2015

By Email

Office of Exemption Determinations  
Employee Benefits Security Administration  
Attn: D-11712 and D-11713  
U.S. Department of Labor  
200 Constitution Avenue, N.W.  
Washington, D.C. 20210

and

Office of Regulations and Interpretations  
Employee Benefits Security Administration  
Attn: Conflict of Interest Rule, Room N-5655  
U.S. Department of Labor  
200 Constitution Avenue N.W.  
Washington, D.C. 20210

***RE: Comments regarding ZRIN: 1210-ZA25 and RIN 1210-AB32***

Ladies and Gentlemen:

On behalf of the U.S. Securities Markets Coalition (“Coalition”),<sup>1</sup> the Options Clearing Corporation (“OCC”), joined by TD Ameritrade, Inc. (“TD Ameritrade”),<sup>2</sup> hereby submit these comments regarding two related proposals issued by the Department of Labor (the “Department”): “Definition of Term ‘Fiduciary’; Conflict of Interest Rule – Retirement

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<sup>1</sup> The members of the Coalition (together with OCC) are BATS Options, BOX Options Exchange, Chicago Board Options Exchange, International Securities Exchange, NASDAQ Options Market, NASDAQ OMX PHLX, NYSE Arca, and NYSE Amex. All of these members are regulated by the Securities and Exchange Commission (“SEC”), and OCC also is regulated by the Commodity Futures Trading Commission and The Board of Governors of the Federal Reserve. NASDAQ Options Market and NASDAQ OMX PHLX are owned by the NASDAQ OMX Group, and NYSE Arca and NYSE Amex are owned by the Intercontinental Exchange Group.

<sup>2</sup> TD Ameritrade is a wholly owned broker-dealer subsidiary of TD Ameritrade Holding Corporation (“AMTD”). AMTD has a 40-year history of providing financial services to self-directed investors. TD Ameritrade provides investing and trading services to over 6.5 million customer accounts that total more than \$702 billion in assets, and custodial services for more than 5000 independent registered investment advisors.

Investment Advice [RIN: 1210-AB32]” (the “Fiduciary Proposal”)<sup>3</sup> and “Proposed Best Interest Contract Exemption, Application No. D-11712 [ZRIN: 1210-ZA25]” (the “BIC Exemption Proposal”) (together, “the Proposal”).<sup>4</sup> The comments herein supplement the comments previously submitted by the Coalition and TD Ameritrade.<sup>5</sup>

During the recent Department hearings on the Proposal, Gary Katz, President and Chief Executive Officer of the International Securities Exchange, testified on behalf of the Coalition regarding the Proposal’s impact on the ability of individual investors to use exchange-traded (or listed) options in their individual retirement accounts (“IRAs”). The Coalition and TD Ameritrade wish to respond to questions raised by the Department staff in response to Mr. Katz’s testimony by providing additional information regarding: (1) the process for permitting individual investors to use options in IRAs; (2) the types of options strategies permitted in IRAs; (3) the education available to investors trading options; and (4) the general compensation structure for brokers related to options trading. In providing this information, we strive to provide the Department with a deeper understanding of the value and prudence of using certain option strategies in retirement accounts. As discussed below, the Coalition and TD Ameritrade request that the Department: (1) revise the BIC Exemption Proposal to add exchange-traded options to the list of permissible asset types; (2) clarify that education or other support that does not rise to the level of a recommendation under FINRA rules would not cause firms to be considered fiduciaries under the Proposal; and (3) clarify that the process firms are required to follow under FINRA and options exchange rules to allow customers to trade listed options would not cause such firms to be considered fiduciaries under the Proposal.

## **I. Options Approval – Regulatory and Firm Requirements**

Under FINRA Rule 2360(b)(16) and the options exchange rules that mirror it, before approving a customer’s account for trading options, a broker must furnish the customer the Options Disclosure Document (“ODD”)<sup>6</sup> and must exercise due diligence to ascertain the essential facts relative to the customer, his/her financial situation and investment objectives, as well as his/her investment experience and knowledge; and approval or disapproval of the account for options trading by a principal of the firm, must be based on such information. For ease of reference, we have attached a copy of FINRA Rule 2360(b)(16) as *Attachment A*.

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<sup>3</sup> 80 FR 21928 (Apr. 20, 2015).

<sup>4</sup> 80 FR 21960 (Apr. 20, 2015).

<sup>5</sup> See Letter from Craig S. Donohue, Executive Chairman, The Options Clearing Corporation, to the Office of Exemption Determinations and Office of Regulations and Interpretations, Employee Benefits Security Administration (July 17, 2015), <<http://www.dol.gov/ebsa/pdf/1210-AB32-2-00420.pdf>> (“Coalition Letter”) and Letter from Ellen L.S. Koplou, EVP and General Counsel, TD Ameritrade Holding Corporation, to the Office of Regulations and Interpretations and Office of Exemption Determinations, Employee Benefits Security Administration (July 21, 2015), <<http://www.dol.gov/ebsa/pdf/1210-AB32-2-00743.pdf>>.

<sup>6</sup> Characteristics & Risks of Standardized Options, <http://www.optionsclearing.com/about/publications/character-risks.jsp>

In compliance with these rules, brokers establish processes for approving customers to trade options at initial account opening, or after a brokerage account is established. In either situation, brokers must provide the appropriate options disclosures (including the ODD), collect the required information, and then have a principal of the firm review and approve the customer's application to trade options. Moreover, similar to a firm's obligation under other FINRA rules, a firm must establish reasonable policies and procedures governing the process for approving a customer to trade listed options.<sup>7</sup> This options account approval process is subject to periodic FINRA inspections to make sure firms are complying with the requirements of the FINRA and options exchange rules. Firms and principals responsible for approving customers to trade options that are found to be out of compliance with the requirements of those rules can be subject to FINRA discipline, including fines and limitations on their activities.

## **II. Types of Options Strategies Permitted in IRAs**

As noted in the Coalition Letter, a broker will typically use "levels" or "tiers" to determine the types of options transactions in which the customer may engage. Where to set these levels/tiers is within the broker's discretion, subject to their interpretation of their obligations under FINRA and options exchange rules as well as the FINRA inspection process. At certain firms, such as TD Ameritrade, IRAs qualified for options trading at: (1) Tier 1 can engage in covered call, protective put and cash covered put transactions; (2) Tier 2 can engage in Tier 1 strategies plus long call and put transactions; and (3) Tier 3 can engage in Tier 1 and 2 strategies plus spread transactions.<sup>8</sup> The two most common options strategies utilized by TD Ameritrade customers approved to trade options are covered calls and protective puts, which as described below, carry limited risks and can be an important and beneficial part of a holistic retirement plan.

### **A. Tier 1**

As noted, TD Ameritrade permits IRAs approved to trade options at Tier 1 to engage in covered call, protective put and cash covered put transactions. These are conservative options

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<sup>7</sup> See FINRA Rules 3110 and 3120.

<sup>8</sup> By way of background, a call gives a purchaser the right, but not the obligation, to purchase a stock at a given time and at a given price, called the strike price. The purchaser pays a premium for this right. In theory, a call works very much like the underlying stock itself. That is, it gains value as the price of the underlying stock increases and decreases in value as the price of the underlying stock decreases. The purchaser can only lose the premium. The seller has the obligation to deliver the stock at the strike price and time described in the call contract.

A put gives the buyer of the put the right, but not the obligation, to sell a specified amount of stock at a given price within a given time. Similar to a call buyer, the put purchaser pays a premium to buy a put. Economically, it works inversely to a call option. That is, the put purchaser has the right to sell the stock and the seller of the put has the obligation to purchase stock at the strike price and time described in the put contract. An investor could purchase a protective put to reduce the risk of losing money if the underlying stock decreases in value.

strategies that involve trading for income, hedging existing positions, or putting on new positions with risks simultaneously hedged, such as engaging in cash covered put transactions in which a customer writes an “at the money” or “out of the money” put option and simultaneously sets aside enough cash to buy the stock, with the ultimate goal of buying the stock for a price less than the current price.

Covered call transactions, which are by far the most common options strategy used in IRAs, allow investors to generate additional income from stock positions and provide a small hedge for such positions should they decline in price. To illustrate how a covered call could be utilized in an IRA, consider a customer retired from years of working at Disney, and who owns a fair amount of its stock. Disney stock was trading at \$115.48 per share on July 6, 2015 at 10:30 CT. The list of September options<sup>9</sup> shows that the September 120 call is trading for approximately \$1.80. One option contract represents 100 shares of stock. Breaking this down, it means that the investor can sell 10 of the September calls (representing 1000 shares) at \$1.80 each,<sup>10</sup> and collect a premium of \$1,800 for the sale of the calls ( $\$1.80 \times 100 \text{ shares per contract} \times 10 \text{ contracts}$ ). This also means that the investor understands that if the stock price increases to \$120 or above, he has the obligation to sell the stock at \$120 per share, or the strike price of the call, and forgo further upside. In total, his effective sale price in such a situation would be \$121.80 ( $\$120 + \$1.80$ ) per share.

In sum, the covered call allows an investor to enhance his return if the stock does not move, or goes up to a price level under the strike price. As with any long stock position, there is a downside of a sell-off in Disney stock. The covered call, however, mitigates this downside risk, because one of the advantages of the covered call is that the investor now has a down side break-even at \$113.68 per share ( $\$115.48 - \$1.80$ ). Thus, this gives some, albeit limited, downside protection to his stock position as well.

Protective put transactions, which are another common options strategy used in IRAs, allow investors who are concerned that stock positions may be ripe for a correction or fall to hedge against such price declines. For example, an investor owning a significant amount of Disney stock currently trading at \$115.48 per share might purchase 10 put options trading at \$0.48 per contract with a strike price of \$100, giving him the right to sell a portion of his Disney stock at \$100 per share until the option’s expiration. In such a transaction, the investor will pay \$480 (plus the \$17.49 transaction fee) for the 10 puts ( $\$0.48 \times 100 \text{ shares per contract} \times 10 \text{ contracts}$ ). The investor is willing to pay this amount for a downside hedge on a portion of his stock position for the period when the options are outstanding, and if the stock moves higher by \$0.48 in that time period, then the cost of the trade (not including transactions costs) would be matched by the increased value of the shares. In the alternative, if the stock were to decline below \$100 per share, the value of the put options would correspondingly increase, providing the investor with a time-limited hedge against declines in the value of his stock position.

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<sup>9</sup> Options expiring in the same month at different prices are called a “chain.” A screen shot of the options chain is included as *Attachment B*.

<sup>10</sup> At TD Ameritrade, the cost of this transaction online would equal \$17.49 -- \$9.99 commission plus \$.075 per contract.

Common, straightforward options strategies such as these can be valuable tools to help investors manage their retirement accounts. With the right tools and education, individual investors can weigh their risk/reward strategies and make thoughtful investment decisions. And if they need assistance along the way, firms like TD Ameritrade should be permitted to provide that assistance, whether through education or other support that does not rise to the level of a recommendation under FINRA rules. In short, activities such as education, determining whether a customer is qualified to trade options, and support that does not rise to the level of a recommendation under FINRA rules, should not result in a broker becoming a fiduciary for retirement accounts. Moreover, as the above examples show, the Department should recognize that options can be an important complement to stock positions held in IRAs and should add them to the list of permissible “Assets” for purposes of the BIC Exemption described in the Proposal. For this purpose, we recommend that options be defined as options that are listed and traded on a national securities exchange and that are used in such a manner that they cannot result in liability in excess of the value of the account engaged in trading with respect to such options.

**B. Tiers 2 and 3**

At firms like TD Ameritrade, customers that possess appropriate experience and knowledge about listed options can be approved for Tier 2 options trading, which allows them to purchase long options. For instance, the purchase of a long call option provides the purchaser of the option with the right to buy the underlying stock at the strike price of the option. Long calls can be used as an alternative to buying a stock outright, and the purchaser can profit if the stock rises, without taking on all of the downside risk that would result from owning the stock. The risk associated with such transactions is the loss of the premium paid for the long option. Using the same option chain from the Disney example above, the price of the September 115 call is \$4.00 at the midpoint. If a customer believed that Disney stock was going to trade higher and wanted to commit a limited amount of capital, the customer could do so by purchasing a call. In this example, if the customer wanted to purchase 10 calls, she could have upside potential with a limited risk of \$4,000 ( $\$4.00 \times 100 \text{ shares per contract} \times 10 \text{ contracts}$ ). The break-even Disney stock price on this trade would be \$119 per share (the strike price of \$115 + \$4.00). This trade would work like owning common stock in that, as the stock moves higher, the call would increase in value, with the exception being that if the stock goes lower the loss is predefined at \$4,000.

At firms like TD Ameritrade, the most sophisticated options customers can be approved for Tier 3 options trading, which allows them to engage in spread transactions. Customers seeking approval for such trading are required to attend advanced education classes, obtain certificates from approved education facilities, pass quizzes, or provide evidence of commensurate experience, as well as satisfy heightened financial requirements.

### **C. IRAs and Margin**

Under FINRA Rule 4210(f)(2)(A)(xxvi)(N), member firms are limited in the types of options transactions that can be conducted in a customer's cash account. As such, in compliance with FINRA Rule 4210, firms allowing options strategies not permitted in cash accounts must establish margin accounts for their customers to engage in such strategies. In order to avoid inadvertent prohibited transactions as well as potential violations of Internal Revenue Code rules specifically applicable to IRAs, however, TD Ameritrade only permits IRAs to trade options that are "risk defined," meaning that the IRA cannot sustain losses that exceed the value of the account. For example, TD Ameritrade and firms like it do not allow options trades that require the firm to lend money to the IRA or the account holder (such as uncovered option writing), or that could otherwise result in losses that exceed the value of the account (such as short sales of securities).<sup>11</sup>

### **III. Options Education Available to IRA Holders**

Firms like TD Ameritrade pride themselves on making extensive education resources available to customers. After opening an account, customers of such firms typically have access to secure websites and education on a variety of subjects, such as: investing strategies (both technical analysis and portfolio management), planning for retirement, stocks, bonds, options, mutual funds and exchange-traded funds, futures, forex and trading tool demonstrations. The education generally is in the form of easy to understand videos that begin with the basics and proceed to more complicated investment analysis and strategies.<sup>12</sup>

These training videos are a representative sample of the hundreds of videos available to customers at firms such as TD Ameritrade after they open an account. Firms like TD Ameritrade view this type of educational material as being very beneficial to its customers, and the type of material that the Department should be encouraging. We reiterate the request that instructional models, videos and interactive materials regarding listed option trading qualify for an investment education carve-out to the definition of fiduciary advice, including with respect to IRAs.

Similarly, we request that the definition of fiduciary advice be modified to leave more room for educational activities. In particular, we would like to see the Department: (i) make the definition more consistent with the FINRA concept of a "call to action" rather than simply a suggestion provided for consideration;<sup>13</sup> and (ii) preserve the current "mutual understanding" requirement.

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<sup>11</sup> See Internal Revenue Code §§ 408(e)(2), 408(e)(4) and 4975(c)(1)(B).

<sup>12</sup> For instance, at firms like TD Ameritrade, the following videos cover the use of options: Options Essentials, Options for Beginners, Investing Basics: Options, Buying and Selling Options, Investing Basics: Covered Calls, Buying and Selling Puts, Covered Calls, Protective Puts, Cash-Secured Puts, Selling a Covered Call, Options for Income, Position Sizing with Options, Reducing Volatility with Options, Diversifying Your Options Strategy, Long Call Trend Trading, Long Put Trend, Put Option Premium, Return on Risk with Options, Call Option Premium, and Long Call Verticals.

<sup>13</sup> See, e.g., FINRA Notice to Members 01-23 (Apr. 2001).

#### **IV. Compensation Model Related to Options Trading**

Firms like TD Ameritrade allow options approved IRAs to buy and sell the universe of exchange-traded options. The prevalent direct compensation model for brokers providing this access is straightforward. Generally, these brokers charge customers a commission (*e.g.*, less than \$10), plus a per-contract charge (*e.g.*, \$.75 per contract) and the pass through of any options exchanges fees, such as the Options Regulatory Fee.<sup>14</sup> Firms like TD Ameritrade believe that these straightforward fees plus the significant utility of the listed options product have been important reasons why their customers are increasingly using listed options.

#### **V. Conclusion**

The Coalition and TD Ameritrade appreciate the opportunity to supplement their prior comments concerning the Department's Proposal. As noted above, we believe individual investors are well-served by having the ability to use options in their IRAs to further their financial and retirement goals. As noted in our earlier letters and above, the Coalition and TD Ameritrade request that the Department:

1. revise the BIC Exemption Proposal to add exchange-traded options to the list of permissible asset types;
2. clarify that education or other support that does not rise to the level of a recommendation under FINRA rules would not cause firms to be considered fiduciaries under the Proposal; and
3. clarify that the process firms are required to follow under FINRA and options exchange rules to allow customers to trade listed options would not cause such firms to be considered fiduciaries under the Proposal.

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<sup>14</sup> The Options Regulatory Fee ("ORF") is a fee assessed by exchanges on their members. As a practical matter, ORF fees typically are passed through by member firms to their customers. The ORF is collected by the OCC on behalf of the U.S. options exchanges. See "Options Regulatory Fee – ORF: A Guide to Exchange Collection Scenarios and Rates" SIFMA (Aug. 1, 2015) <[https://www.sifma.org/uploadedfiles/issues/capital\\_markets/listed\\_options/sifmalotcorf.pdf](https://www.sifma.org/uploadedfiles/issues/capital_markets/listed_options/sifmalotcorf.pdf)>.

Thank you for your consideration of this request. If you have any questions regarding these matters, please do not hesitate to contact us.

Respectfully Submitted,

A handwritten signature in black ink that reads "Craig S. Donohue". The signature is written in a cursive style with a prominent initial "C".

Craig S. Donohue  
Executive Chairman  
The Options Clearing Corporation

A handwritten signature in black ink that reads "Ellen L.S. Koplou". The signature is written in a cursive style with a prominent initial "E".

Ellen L.S. Koplou  
EVP and General Counsel  
TD Ameritrade Holding Corporation



## Attachment A

### FINRA Rule 2360 (b)(16)

#### (16) Opening of Accounts

##### (A) Approval Required

No member or person associated with a member 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.

##### (B) Diligence in Opening Accounts

In approving a customer's account for options trading, a member or any person associated with a member 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 paragraph (b)(17).

### **(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 FINRA 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 under this subparagraph (16) 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 paragraph (b)(3) and the exercise limits established pursuant to paragraph (b)(4).

**(E) Uncovered Short Option Contracts [rule text not included]**

## Attachment B

### Screenshot of Option Chain Used in Examples

DIS WALT DISNEY CO COM
HTB B: 115.39  
A: 115.41 **115.3928** +.4228  
+0.37%

UNDERLYING


Last X	Net Chng	Bid X	Ask X	Size	Volume	Open	High	Low
115.48 D	+4228	115.47 N	115.49 N	8 x 4	1,855,563	114.47	115.86	114.27

TRADE GRID

OPTION CHAIN Filter: Off Spread: Single Layout: Volume, Open Interest

Strikes: 10

CALLS				PUTS					
Volume	Open Int	Bid X	Ask X	Exp	Strike	Bid X	Ask X	Volume	Open Int
JUL 15 (11) 100									
AUG 15 (46) 100									
SEP 15 (74) 100									
0	2	28.55 C	31.10 C	SEP 15	85	.08 C	10 H	1	42
0	3	24.10 C	26.15 C	SEP 15	90	.13 C	18 A	0	26
5	5	20.45 C	21.40 M	SEP 15	95	.24 X	28 C	0	10
2	5	15.60 M	16.55 M	SEP 15	100	<b>.45 I</b>	<b>.48 C</b>	<b>0</b>	<b>140</b>
1	66	11.20 C	11.80 A	SEP 15	105	.86 M	.91 C	2	579
1	482	7.10 C	7.45 A	SEP 15	110	1.72 C	1.83 C	17	782
170	898	3.95 C	4.05 X	SEP 15	115	3.45 C	3.55 C	61	279
<b>224</b>	<b>1,635</b>	<b>1.78 C</b>	<b>1.89 X</b>	SEP 15	120	6.30 C	6.45 X	37	103
100	452	.73 C	.79 C	SEP 15	125	9.85 A	10.50 A	0	13
0	37	.30 B	.33 C	SEP 15	130	14.75 M	16.00 A	0	0
OCT 15 (102) 100									
JAN 16 (193) 100									
JAN 17 (564) 100									



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