SECURITIES AND EXCHANGE COMMISSION


Self-Regulatory Organizations; Nasdaq ISE, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Box and Butterfly Spread Protections

June 19, 2018.

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 June 7, 2018, Nasdaq ISE, LLC (“ISE” or the “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II 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


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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of those 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: (i) Adopt Complex Order protections for Butterfly and Box Spread protections for Complex Order strategies; and (ii) reorganize and amend the existing Complex Order protections currently contained within .07 of Supplementary Material to Rule 722 and Rule 714. These amendments will be described in greater detail below. This rule change is similar to protections, which exist today on Nasdaq Phlx LLC (“Phlx”).4

Adopt Butterfly and Box Spread Protections

Today, ISE members may submit Butterfly and Box spreads into the System. ISE proposes to define a Butterfly spread as a three legged Complex Order with certain characteristics.5 The Exchange is proposing to reject Butterfly spreads which are outside of certain parameters to avoid potential executions at prices that exceed the minimum and maximum possible intrinsic value of the spread by a specified amount. Additionally, ISE proposes to define a Box spread as a four legged Complex Order with certain characteristics.6 The Exchange is proposing to reject Box spreads which are outside of certain parameters to avoid potential executions at prices that exceed the minimum and maximum possible intrinsic value of the spread by a specified amount. Today, the Exchange offers similar order protection features for Complex Orders such as Vertical and Calendar Spread Protections7 to avoid erroneous trades.

Butterfly Spread Protection

As noted above, the Exchange proposes to adopt a Butterfly Spread Protection. A Butterfly Spread is a three legged Complex Order with the following: (1) Two legs to buy (sell) the same number of calls (puts); (2) one leg to sell (buy) twice the number of calls (puts) with a strike price at mid-point of the two legs to buy (sell); (3) all legs have the same expiration; and (4) each leg strike price is equidistant from the next sequential strike price. With this protection, a Butterfly Spread Limit Order that is priced higher than the Maximum Value (defined below) or lower than the Minimum Value (defined below) will be rejected. A Butterfly Spread Market Order (or Butterfly Spread Limit Order entered with a net price inside the Butterfly Spread Protection Range) to Buy (Sell) will be restricted from executing by legging into the single leg market with a net price higher (lower) than the Maximum (Minimum) Value. The Butterfly Spread Protection Range is the absolute difference between the Minimum Value and the Maximum Value.

ISE’s proposal continues to protect Butterfly Spreads from legging into the single leg market(s), similar to Phlx Rule 1098(i), at a price higher than the Maximum Value for buy orders and lower than the Minimum Value for sell orders. ISE’s proposal differs from Phlx in that ISE allows legging below the Minimum Value for buys and above the Maximum Value for sells at a price made available by the synthetic (cIBBO) market outside of the Butterfly Spread Protection Range.8

The Exchange believes that these limitations, which exist today for ISE Vertical and Calendar Spreads,9 are consistent with the Act because the limits permit buying below the minimum and selling above the maximum thereby allowing buyers and sellers to achieve better prices without taking on additional risk. The intrinsic value for the Butterfly Spread that could be achieved when closing the position would not be negatively impacted in

3 A complex order is any order involving the simultaneous purchase and/or sale of two or more different options series in the same underlying security, for the same account, in a ratio that is equal to or greater than one-to-three (.333) and less than or equal to three-to-one (3.00) and for the purpose of executing a particular investment strategy. See ISE Rule 722(a)(1).
4 This rule change is similar to Phlx Rule 1098(i) and (j).
5 This strategy utilizes a combination of either all calls or all puts of the same expiration date in the same underlying to limit risk.
6 This strategy utilizes a combination of put/call pairs of options with the same expiration date in the same underlying to limit risk.
7 See Supplementary Material .07(c) to ISE Rule 722.
8 Allowed selling trades to trade by legging into the simple market at prices above the Minimum Value (buy orders below the Minimum Value) offers an opportunity for buyers/buyers to receive a premium beyond the potential intrinsic value of the spread without creating risk for the Complex Order Book.
9 Id.
this case because the limitation permits price improvement. The Exchange notes, however, that in certain situations, market participants willingly want to execute certain trading strategies even if such trades occur outside their intrinsic value or at seemingly erroneous prices (e.g., negative price). The Exchange believes it is appropriate to provide market participants flexibility to allow them to execute these trading strategies and therefore to adopt a buffer to permit the execution of such trading strategies. The Exchange believes it is reasonable to adopt a buffer to give the Exchange the ability to adjust the pre-set value uniformly across all options classes in the event the Exchange believes a different pre-set value is more appropriate. Finally, the Exchange notes that it provides these protections for the benefit of, and in consultation with, its Members. The Exchange believes the proposed rule change will help the Exchange to maintain a fair and orderly market, and provide a valuable service to investors.

The Initial Maximum Value shall be the distance between the strike price of the leg with the mid-point strike price and the strike price of the outer leg strike prices. The Maximum Value Buffer is the lesser of a configurable absolute dollar value or percentage of the Initial Maximum Value set by the Exchange and announced via a notice to members. The Exchange intends to set the Value Buffer at zero initially. The Maximum Value is calculated by adding the Initial Maximum Value and Maximum Value Buffer. The Initial Maximum Value shall be zero. The Maximum Value Buffer is a configurable absolute dollar value set by the Exchange and announced via a notice to members. The Exchange intends to set the Maximum Value Buffer at zero initially. The Exchange would monitor the zero value, including feedback from market participants, in determining whether the value is set at the appropriate level. The decision to change the buffer could stem from participant concern for their ability to close out positions. The Minimum Value is calculated by subtracting the Minimum Value Buffer from the Initial Minimum Value of zero. There are circumstances where the Minimum Value may be less than zero.11

The Butterfly Spread Protection would apply throughout the trading day, including pre-market, during the Opening Process and during a trading halt. Unlike Phlx, but similar to ISE Vertical and Calendar spreads, these protections will not apply to Complex Orders being auctioned in the Facilitation, Solicitation, Price Improvement mechanism and associated auction responses. Also, today, the Vertical and Calendar spreads do not apply to Customer Cross Orders.12 The Exchange is adding Customer Cross Orders to the list of excluded order types that are not protected by the Vertical, Calendar, Box or Butterfly spread protections. Complex orders executed in these mechanisms are two-sided orders where the contra-side order is willing to trade with the agency order at an agreed upon price thus removing the risk that the order was executed erroneously outside its intrinsic value. Similarly, a Customer Cross Order is a two-sided order where the contra-side order is willing to trade with the agency order at an agreed upon price. The Exchange believes that because paired orders are negotiated in advance by both parties it is unlikely that the parties would agree to transact at prices that would necessitate the protections proposed within the Butterfly Spread Protection.

Below is an example of the application of this protection.

Example 1

Assume the following Complex Order legs for a Butterfly Spread:
1. Buy 1 NDX 6960 Jan 26 Call (33.70 × 34.60)
2. Sell 2 NDX 6970 Jan 26 Calls (27.00 × 27.90)
3. Buy 1 NDX 6980 Jan 26 Call (28.40 × 29.50)

The derived net ISE Complex Order market (‘‘cIBBO’’) is 6.30 × 10.10

Assume both the Maximum Value Buffer and Minimum Value Buffer are 0.00

Minimum Value = 0.00
• Initial Minimum Value: 0.00
• Minimum Value Buffer: 0.00
• Minimum Value: 0.00 – 0.00 = 0.00

Maximum Value = 10
• Initial Maximum Value: 6970 (middle leg strike price) – 6960 (outer leg strike price) = 10.00
• Maximum Value Buffer: 0.00
• Maximum Value: 10.00 (Initial Maximum Value) + 0.00 (Maximum Value Buffer) = 10.00

An incoming order to buy the spread defined above for 10.10 will be rejected because the purchase price of 10.10 is greater than the Maximum Value of 10.00.

Example 2

Assume the following Complex Order legs for a Butterfly Spread:
1. Buy 1 NDX 6960 Jan 26 Call (33.70 × 34.60)
2. Sell 2 NDX 6970 Jan 26 Calls (27.00 × 27.90)
3. Buy 1 NDX 6980 Jan 26 Call (28.40 × 29.50)

The derived net ISE Complex Order market (‘‘cIBBO’’) is 6.30 × 10.05

Assume both the Maximum Value Buffer and Minimum Value Buffer are 0.05

Minimum Value = –0.05
• Initial Minimum Value: 0.00
• Minimum Value Buffer: 0.05
• Minimum Value: 0.00 – 0.05 = –0.05

Maximum Value = 10.05
• Initial Maximum Value: 6970 (middle leg strike price) – 6960 (outer leg strike price) = 10.00
• Maximum Value Buffer: 0.05
• Maximum Value: 10.00 (Initial Maximum Value) + 0.05 (Maximum Value Buffer) = 10.05

An incoming order to buy the spread defined above for 10.05 will be accepted and executed against the simple market because the purchase price of 10.05 is equal to the Maximum Value 10.05.

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10 A small incremental allowance outside of the Minimum/Maximum Value allows for a small premium to offset commissions associated with trading and may incentivize participants to take the other side of spreads trading at or slightly outside of the intrinsic value. For the participant looking to close out their position, it may be financially beneficial to pay a small premium and close out the position rather than carry such position to expiration and take delivery. The purpose of this rule change is not to impede current order handling but to ensure execution prices are within a reasonable range of minimum and maximum values.

11 For example, market participants who desire to trade out of positions at intrinsic value may not find a contra-side willing to trade without a premium. A small incremental allowance outside of the minimum/maximum value allows for a small premium to offset commissions associated with trading and may incentivize participants to take the other side of spreads trading at intrinsic value. For the participant looking to close out their position, it may be financially beneficial to pay a small premium and close out the position rather than carry such position to expiration and take delivery. See ISE Rule 722 at Supplementary Material .07(c).

12 A Customer Cross Order is comprised of a Priority Customer Order to buy and a Priority Customer Order to sell at the same price and for the same quantity. See ISE Rule 715(i).

13 The cIBBO is calculated by deriving the synthetic bid and offer available in the simple market with the ratio of each option leg of the spread considered. The 6.30 number is arrived at by multiplying (1 × 33.70) then subtracting (2 × 27.90) and adding (1 × 28.40). The 10.05 number is derived by multiplying (1 × 34.60) then subtracting (2 × 27.00) and adding (1 × 29.50).

14 The cIBBO is calculated by deriving the synthetic bid and offer available in the simple market with the ratio of each option leg of the spread considered.
Box Spread Protection

As noted above, the Exchange proposes to adopt a Box Spread Protection. A Box Spread is a four legged Complex Order with the following: (1) One pair of legs with the same strike price with one leg to buy a call (put) and one leg to sell a put (call); (2) a second pair of legs with a different strike price from the pair described in (1) with one leg to sell a call (put) and one leg to buy a put (call); (3) all legs have the same expiration; and (4) all legs have equal volume. With this protection, a Box Spread Limit Order that is priced higher than the Maximum Value or lower than the Minimum Value will be rejected. A Box Spread Market Order (or Box Spread Limit Order entered with a net price inside the Box Spread Protection Range) to Buy (Sell) will be restricted from executing by legging into the single leg market with a net price higher (lower) than the Maximum (Minimum) Value. The Box Spread Protection Range is the absolute difference between the Minimum Value and the Maximum Value.

ISE’s proposal continues to protect Box Spreads from legging into the single leg market(s), similar to Phlx Rule 1098(j), at a price higher than the Maximum Value for buy orders and lower than the Minimum Value for sell orders. ISE’s proposal differs from Phlx in that ISE allows legging below the Minimum Value for buys and above the Maximum Value for sells at a price made available by the synthetic (cIBBO) market outside of the Box Spread Protection Range.17

The Exchange believes that these limitations, which exist today for ISE Vertical and Calendar Spreads, are consistent with the Act because the limits permit buying below the minimum and selling above the maximum thereby allowing buyers and sellers to achieve better prices without taking on additional risk. The intrinsic value for the Box Spread that could be achieved when closing the position would not be negatively impacted in this case because the limitation permits price improvement as noted above for Butterfly Spreads.

The Initial Maximum Value shall be the distance between the strike prices of each pair of leg strike prices. The Maximum Value Buffer is the lesser of a configurable absolute dollar value or percentage of the Initial Maximum Value set by the Exchange and announced via a notice to members. The Exchange intends to set the Maximum Value Buffer at zero initially. The Maximum Value is calculated by adding the Initial Maximum Value and Maximum Value Buffer.

The Initial Minimum Value shall be zero. The Minimum Value Buffer is a configurable absolute dollar value set by the Exchange and announced via a notice to members. The Exchange intends to set the Minimum Value Buffer at zero initially. The Minimum Value is calculated by subtracting the Minimum Value Buffer from the Initial Minimum Value of zero.

The Box Spread Protection would apply throughout the trading day, including pre-market, during the Opening Process and during a trading halt. The protections will not apply to Complex Orders in the Facilitation, Solicitation, Price Improvement mechanism and associated auction responses. The Box Spread Protection will also not apply to Customer Cross Orders. Unlike Phlx, but similar to ISE Vertical and Calendar spreads, these protections will not apply to Complex Orders being auctioned in the Facilitation, Solicitation, Price Improvement mechanism and associated auction responses. Also, today, the Vertical and Calendar spreads do not apply to Customer Cross Orders. The Exchange is adding Customer Cross Orders to the list of excluded order types that are not protected by the Vertical, Calendar, Box or Butterfly spread protections. Complex orders executed in these mechanisms are two-sided orders where the contra-side order is willing to trade with the agency order at an agreed upon price thus removing the risk that the order was executed erroneously outside its intrinsic value. Similarly, a Customer Cross Order is a two-sided order where the contra-side order is willing to trade with the agency order at an agreed upon price. The Exchange believes that because paired orders are negotiated in advance by both parties it is unlikely that the parties would agree to transact at prices that would necessitate the protections proposed within the Box Spread Protections.

Example 1
Assume the following Complex Order pairs for a Box Spread:

1. Pair A
   a. Buy 1 NDX 6960 Jan 26 Call (30.80 × 34.05)
   b. Sell 1 NDX 6960 Jan 26 Put (33.50 × 36.00)

2. Pair B
   a. Sell 1 NDX 6970 Jan 26 Call (27.50 × 29.00)
   b. Buy 1 NDX 6970 Jan 26 Put (36.40 × 37.05)

The derived net ISE Complex Order market (“cIBBO”) is 2.20 × 10.10

Assume both Maximum Value Buffer and Minimum Value Buffer are 0.00
Minimum Value = 0.00
• Initial Minimum Value: 0.00
• Minimum Value Buffer: 0.00
• Minimum Value: 0.00 – 0.00 = 0.00
Maximum Value = 10.00
• Initial Maximum Value: 6970 (Pair A strike price) – 6960 (Pair B strike price) = 10.00
• Maximum Value Buffer: 0.00
• Maximum Value: 10.00 (Initial Maximum Value) + 0.00 (Maximum Value Buffer) = 10.00

An incoming order to buy the spread defined above for 10.10 will be rejected because the purchase price of 10.10 is greater than the Maximum Value of 10.00.

Example 2
Assume the following Complex Order pairs for a Box Spread:

1. Pair A
   a. Buy 1 NDX 6960 Jan 26 Call (30.80 × 34.05)
   b. Sell 1 NDX 6960 Jan 26 Put (33.50 × 36.50)

2. Pair B
   a. Sell 1 NDX 6970 Jan 26 Call (27.50 × 30.75)
   b. Buy 1 NDX 6970 Jan 26 Put (36.40 × 37.05)

The derived net ISE Complex Order market (“cIBBO”) is −0.05 × 10.10

Assume both Maximum Value Buffer and Minimum Value Buffer are 0.05
Minimum Value = −0.05
• Initial Minimum Value: 0.00
• Minimum Value Buffer: 0.05
• Minimum Value: 0.00 – 0.05 = −0.05
Maximum Value = 10.05
• Initial Maximum Value: 6970 (Pair

17 Allowing sell orders to trade by legging into the simple market at prices above the Maximum Value (buy orders below the Minimum Value) offers an opportunity for sellers/buyers to receive a premium beyond the potential intrinsic value of the spread without creating risk for the Complex Order Book.
18 See Supplementary Material 07(c) to ISE Rule 722.
19 Id.
20 The cIBBO is calculated by deriving the synthetic bid and offer available in the simple market with the ratio of each option leg of the spread considered.
21 The cIBBO is calculated by deriving the synthetic bid and offer available in the simple market with the ratio of each option leg of the spread considered.
A strike price) – 6960 (Pair B strike price) = 10.00
• Maximum Value Buffer: 0.05
• Maximum Value: 10.00 (Initial
Maximum Value) + 0.05 (Maximum
Value Buffer) = 10.05
An incoming order to sell the spread
defined above for – 0.05 will be
accepted and executed against the
simple market because the purchase
price of -0.05 is equal than the
Minimum Value of – 0.05. Phlx has a
similar protection in place today.22
Reorganize and Amend Supplementary
Material .07 to Rule 722
The Exchange proposes to reorder the
rule and title subsection “a” as “Price
limits for Complex orders and quotes.”
The Exchange proposes to rename .07 as
“Complex Order Protections.” The
Exchange proposes to list all available
Complex Order protections on ISE
within Supplementary Material .07 to
Rule 722.
Universal Changes
The Exchange proposes to reorder the
section and title subsection “a” as “Price
limits for Complex Orders and quotes.”
The Exchange is proposing to capitalize
defined terms throughout this section
for consistency. The Exchange removed
cross-references that are no longer
necessary with the reorganization. The
Exchange proposes to re-letter and
renumber this section to accommodate
all the price protections. The Exchange
also proposes adding titles throughout
.07 to add more context to the rules.
Proposed Supplementary Material to
Rule 722 at .07(b) shall be titled,
“Strategy Protections.” Proposed
Supplementary Material to Rule 722 at
.07(c) shall be titled, “Other Price
Protections which apply to Complex
Orders.”
Price Limits
With respect to the price limits
specified in proposed Rule 722 at
Supplementary Material .07(a)(1) the
Exchange proposes a substantive
amendment to revise the second
sentence which currently provides,
“Notwithstanding, the System will not
permit any leg of a complex order to
trade through the NBBO for the series by
a configurable amount calculated as the
lesser of (i) an absolute amount not to
exceed $0.10, and (ii) a percentage of
the NBBO not to exceed 500%, as
determined by the Exchange on a class
or series basis.” The Exchange originally
filed this rule to permit ISE to configure
settings for this protection on a class or
series basis. The Exchange proposes to
amend the ability to configure settings.
Similar to the proposed Butterfly and
Box Spread protections, the Exchange
proposes to apply the settings uniformly
across all classes.
Strategy Protections
The Exchange proposes introducing
ISE Rule 722 at Supplementary Material
.07(b) with the following text, “The
following protections will apply
throughout the trading day, including
pre-market, during the Opening Process
and during a trading halt.” Today, the
Vertical and Calendar Spread
Protections apply throughout the
trading day, including pre-market,
during the Opening Process and during
a trading halt. The Exchange provides
for no limitations in the Vertical and
Calendar Spread Protections with
respect to any limitations during
specific trading sessions. The Exchange
also does not intend for such limitations
to apply for Box and Butterfly Spread
Protections. The Exchange believes that
adding this affirmative language will
simply serve to remove any confusion
on whether the protections do not apply
during a specific trading session.
The Exchange also proposes to add
another sentence to the introduction of
new section (b) which provides “The
protections will not apply to Complex
Orders being auctioned and auction
responses in the Facilitation
Mechanism, Solicited Order
Mechanism, and Price Improvement
Mechanism and will not apply to
Customer Cross Orders.” Today, the
protections for Vertical Spread
Protection and Calendar Spread
Protections do not apply to Complex
Orders being auctioned and auction
responses in the Facilitation
Mechanism, Solicited Order
Mechanism, and Price Improvement
Mechanism and Customer Cross
Orders.23 The Exchange is proposing
these same limitations for Box and
Butterfly Spreads. Complex orders
executed in these mechanisms are
two-sided orders where the contra-side
order is willing to trade with the agency
order at an agreed upon price thus removing
the risk that the order was executed
erroneously outside its intrinsic value.
Vertical Spread Protections
The Exchange proposes amending ISE
Rule 722 at Supplementary Material
.07(b)(1) similar to the Box and
Butterfly Spread protections, to begin
the section with the same conforming
language indicating which strategy the
Vertical Spread Protection applies to
and also relocating the definition of a
Vertical Spread to the initial paragraph.
The Exchange is amending proposed
ISE Rule 722 at Supplementary Material
.07(b)(1)(A) to relocate the language in
current Rule 722 at Supplementary
Material .07(c)(4)(i)24 and .07(c)(5)25
into the actual paragraph rather than
referring back to the paragraph.26 The
Exchange proposes the following rule
text, “The Exchange will set a common
pre-set value not to exceed $1.00 to be
applied uniformly across all classes.
The Exchange may amend the pre-set
value uniformly across all classes” at
proposed ISE Rule 722 at
Supplementary Material .07(b)(1)(A).
The Exchange notes that proposed ISE
Rule 722 at Supplementary Material
.07(b)(1)(B) already has a sentence
which states, “The pre-set value is the
lesser of an absolute amount and a
percentage of the difference between the
strike prices.” Instead of also relocating
ISE Rule 722 at Supplementary Material
.07(c)(4)(i) and (c)(5), the Exchange
proposes to state “The pre-set value used by
the vertical spread check will be the lesser
of (1) an absolute amount not to exceed
$1.00 and (2) a percentage of the
difference between the strike prices.
Notwithstanding, the System will not
permit any leg of a complex order to
equally outside its intrinsic value.”

24 Rule 722 at Supplementary Material .07(c)(4)(i)
provides, “For purposes of the price protections set
forth in paragraphs (c)(1) and (c)(3), the Exchange
will set a common pre-set value not to exceed $1.00
to be applied uniformly across all classes.”
25 Rule 722 at Supplementary Material .07(c)(5)
provides, “The Exchange may change the pre-set
values established in paragraph (c)(4) in accordance
with the parameters set forth therein from time to
time uniformly across all classes.”
26 The words, “For purposes of the price protections set
forth in paragraphs (c)(1) and (c)(3)” and “established in paragraph (c)(4) in accordance
with the parameters set forth therein from time to
time” are not being carried into the rule text as they
are no longer necessary.
27 ISE Rule 722 at Supplementary Material
.07(c)(4)(ii) provides, “For purposes of the price
protections set forth in paragraph (c)(1) and (c)(3), the
Exchange will set common pre-set values of (1) an
amount not to exceed $1.00 and (2) a percentage of
the difference between strike prices not to exceed
10% to be applied uniformly across all classes.”
28 ISE Rule 722 at Supplementary Material
.07(c)(5) provides, “The Exchange may change the pre-set
values established in paragraph (c)(4) in accordance
with the parameters set forth therein from time to
time uniformly across all classes.”
22 See note 4 above.
believes that this proposed rule text more efficiently explains the relevant provisions and removes unnecessary text.

Calendar Spread Protections

The Exchange proposes amending ISE Rule 722 at Supplementary Material .07(b)(2), similar to the Box and Butterfly Spread protections, to begin the section with the same conforming language indicating which strategy the Calendar Spread Protection applies to and also relocating the definition of a Calendar Spread to the initial paragraph. The Exchange is also relocating language in current Rule 722 at Supplementary Material .07(c)(4)(i) into the actual paragraph rather than referring back to the paragraph. The Exchange also proposes to relocate current Rule 722 at Supplementary Material .07(c)(5) into proposed ISE Rule 722 at Supplementary Material .07(b)(2) and amending the language to conform to the text in the remainder of the rule. The Exchange proposes to eliminate the remainder of the rule text currently in Supplementary Material to Rule 722 at .07(c)(4)(ii) and (ii) and .07(c)(5) because the language has been relocated within the proposed text as described herein.

Other Price Protections

The Exchange proposes to add to ISE Rule 722 new Supplementary Material .07(c) entitled “Other Price Protections which apply to Complex Orders” and relocate Limit Order Price Protection to .07(c)(1). The Exchange proposes to relocate Size Limitation to ISE Rule 722 at Supplementary Material .07(c)(2). Finally, the Exchange proposes to relocate Price Level Protection from Rule 714(b)(4) to Rule 722 at Supplementary Material .07(c)(3). The Exchange proposes to remove the first sentence which provides, “This protection shall apply to Complex Orders.” because this rule is not within a Complex Order rule currently and will not need that indication once the rule text is relocated to Rule 722. The Exchange also proposes to amend the last sentence of that rule which currently provides, “The number of price levels for the component leg which may be between one (1) and ten (10), is determined by the Exchange from time-to-time on a class-by-class basis.” The Exchange believes indicating between one and ten could be misleading because the setting could be numbers 1 and 10 so “from one (1) to ten (10)” is being proposed to make that more clear.

Rule 714

Finally, the Exchange proposes to amend Rule 714(b) to make clear that the protections in that rule apply to single leg orders. The Exchange is placing protections for Complex Orders into Rule 722 and relocating the Price Level Protection rule related to Complex Orders. The additional clarifying language to single leg and cross-reference to Supplementary Material .07 to ISE Rule 722 should make clear to Members where the various price protections are located.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act, in general, and furthers the objectives of Section 6(b)(5) of the Act, 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, by offering protections for certain Complex Orders which restrict executions that exceed the intrinsic value of the spread by a specified (or configurable) amount. Further, the Exchange believes that its proposal will mitigate risks to market participants. Specifically, ISE believes that the change, which is responsive to member input, will facilitate transactions in securities and perfect the mechanism of a free and open market by providing its Members with additional functionality that will assist them with managing their risk by checking each Complex Order that is either a Butterfly or Box spread against certain parameters described within the filing before accepting the Complex Orders into the order book.

The Exchange believes that the parameters described herein, including parameters which will be configured by the Exchange, will protect members from executing orders too far outside the Minimum Value and Maximum Value which considers the intrinsic value of the strategy, thereby promoting fair and orderly markets and the protection of investors. The Exchange intends to offer a buffer allowance from the minimum/maximum values permitted for the execution of these strategy orders to allow market participants flexibility to manage their business and accommodate executions outside of this range. The Exchange would monitor the zero value, including feedback from market participants, in determining whether the value is set at the appropriate level. The decision to change the buffer could stem from participants’ concern for their ability to close out positions. There are circumstances where the Minimum Value may be less than zero. For example, market participants who desire to trade out of positions at intrinsic value may not find a contra-side willing to trade without a premium. A small incremental allowance outside of the minimum/maximum value allows for a small premium to offset commissions associated with trading and may incentivize participants to take the other side of spreads trading at intrinsic value. For the participant looking to close out their position, it may be financially beneficial to pay a small premium and close out the position rather than carry such position to expiration and take delivery. The purpose of this rule change is not to impede current order handling but to ensure execution prices are within a reasonable range of minimum and maximum values.

These protections are very similar to protections on Phlx. ISE’s proposal continues to protect Butterfly and Box Spreads from legging into the single leg market(s), similar to Phlx Rule 1098(i) and (j), at a price higher than the Maximum Value for buy orders and lower than the Minimum Value for sell orders. Further, ISE’s proposal differs from Phlx in that ISE allows legging below the Minimum Value for buys and above the Maximum Value for sells at a price made available by the synthetic (cIBBO) market outside of the Butterfly and Box Spread Ranges. The Exchange believes that these limitations, which exist today for ISE Vertical and Calendar Spreads, are consistent with the Act because the limits permit buying below the minimum and selling above the maximum thereby allowing buyers and sellers to achieve better prices without

30 “The word “protection” as used herein is intended to mean any and all type of protection that the Exchange believes is necessary.”
31 Limit Order Price Protection is currently at ISE Rule 722 at Supplementary Material .07(d).
32 Size Limitation is currently at ISE Rule 722 at Supplementary Material .07(e).
33 As noted above the Price Level Protection rule is being relocated to ISE Rule 722 at Supplementary Material .07(c)(3).
36 See Phlx Rule 1098(i) and (j).
37 See Supplementary Material .07(c) to ISE Rule 722.
taking on additional risk. The intrinsic value for the Box Spread and the Butterfly Spread that could be achieved when closing the position would not be negatively impacted in this case because the limitation permits price improvement as noted above for Box Spreads and Butterfly Spreads.

The Exchange’s proposal to exclude the Butterfly and Box Spread Protections from Complex Orders being auctioned and auction responses in the Facilitation Mechanism, Solicited Order Mechanism, and Price Improvement Mechanism is consistent with the Act because it conforms to the behavior of other protections on ISE protection including the protections for Vertical Spread and Calendar Spreads. Complex Orders executed in these mechanisms are two-sided orders where the contra-side order is willing to trade with the agency order at an agreed upon price thus removing the risk that the order was executed erroneously outside its intrinsic value. The Box and Butterfly Spread Protection will not apply to Customer Cross Orders. Unlike Phlx, but similar to ISE Vertical and Calendar spreads, these protections will not apply to Complex Orders being auctioned in the Facilitation, Solicitation, Price Improvement mechanism and associated auction responses. Also, today, the Vertical and Calendar spreads do not apply to Customer Cross Orders. The Exchange is adding Customer Cross Orders to the list of excluded order types that are not protected by the Vertical, Calendar, Box or Butterfly Spread Protections. Complex orders executed in these mechanisms are two-sided orders where the contra-side order is willing to trade with the agency order at an agreed upon price thus removing the risk that the order was executed erroneously outside its intrinsic value. Similarly, a Customer Cross Order is a two-sided order where the contra-side order is willing to trade with the agency order at an agreed upon price. The Exchange believes that because paired orders are negotiated in advance by both parties it is unlikely that the parties would agree to transact at prices that would necessitate the protections proposed within the Box and Butterfly Spread Protections.

The Exchange believes that the proposed amendments to Supplementary Material .07 to ISE Rule 722 further clarify the existing rules and conform the structure of the rules to the proposed Butterfly and Box Spread protections. The Exchange believes that reorganizing Supplementary Material .07 to ISE Rule 722 by adding titles, capitalizing defined terms, reorganizing the letters and numbers and consolidating text will protect investors and the public interest by adding greater transparency to the rules. The Exchange also notes that it is adding clarifying language to the rule text and relocating the Price Level Protection from Rule 714, which concerns single leg protections to Rule 722 at Supplementary Material .07, which concerns Complex Order protections. The Exchange believes that amending proposed Supplementary Material .07(a)(1) to ISE Rule 722 to apply the setting uniformly across all markets rather than on a class or series basis will align this protection to the manner in which all other protections are applied for Complex Orders. The Exchange believes that uniformly applying the setting is consistent with the Act because it will apply the protection in the same manner regardless of class.

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 not necessary or appropriate in furtherance of the purposes of the Act. Specifically, the proposal does not impose an intra-market burden on competition, because it will apply to all Complex Orders, which are either Butterfly or Box spreads entered by any ISE Member. Further, the proposal will not impose an undue burden on intra-market competition, because the proposal will assist the Exchange in remaining competitive in light of protections offered by other options exchanges. The Exchange competes with many other options exchanges, which offer Complex Orders. In this highly competitive market, market participants can easily and readily direct order flow to competing venues. The Exchange believes that not applying the Box and Butterfly Spread protections will help market participant mitigate risk by preventing the execution of Butterfly and Box Spreads at prices that are outside of specified minimum and maximum values. The Commission notes that the Box and Butterfly Spread

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

The Exchange has filed the proposed rule change pursuant to Section 19(b)(3)(A) of the Act and Rule 19b–4(f)(6) thereunder.43 Because the 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) of the Act and Rule 19b–4(f)(6) thereunder.

A proposed rule change filed under Rule 19b–4(f)(6) normally does not become operative for 30 days after the date of the filing. However, pursuant to Rule 19b–4(f)(6)(iii), the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest. In its filing with the Commission, the Exchange has asked the Commission to waive the 30-day operative delay so that the proposal may become operative immediately upon filing so that the Exchange may immediately offer the Box and Butterfly Spread protections, which are offered on Phlx, and remain competitive with other markets. The Commission believes that waiver of the 30-day operative delay is consistent with the protection of investors and the public interest because the Box and Butterfly Spread protections will help market participant mitigate risk by preventing the execution of Butterfly and Box Spreads at prices that are outside of specified minimum and maximum values. The Commission notes that the Box and Butterfly Spread

44 In addition, Rule 19b–4(f)(6)(iii) 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.
protections are substantially similar to protections offered on Phlx. Therefore, the Commission designates the proposed rule change operative upon filing.47

At any time within 60 days of the filing of such 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 under Section 19(b)(2)(B) of the Act 48 to determine whether the proposed rule change 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:

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–ISE–2018–55 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–ISE–2018–55. 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 website (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 such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–ISE–2018–55, and should be submitted on or before July 16, 2018.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.49

Eduardo A. Aleman,

Assistant Secretary.

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Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Order Instituting Proceedings To Determine Whether To Approve or Disapprove a Proposed Rule Change, as Modified by Amendment No. 2 Thereto, To List and Trade Shares of Eighteen ADRPLUS Funds of the Precidian ETFs Trust Under Rule 14.11(i), Managed Fund Shares

June 19, 2018.

I. Introduction

On March 5, 2018, Cboe BZX Exchange, Inc. filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)1 and Rule 19b–4 thereunder, a proposed rule change to list and trade shares (“Shares”) of eighteen ADRPLUS Funds (“Funds”) of the Precidian ETFs Trust (“Trust”). The proposed rule change was published for comment in the Federal Register on March 21, 2018.2 On April 25, 2018, the Exchange filed Amendment No. 1 to the proposed rule change,3 and the Commission, pursuant to Section 19(b)(2) of the Act,4 designated a longer

4 Amendment No. 1 replaced and superseded the original rule filing in its entirety. Amendment No. 1 is available at https://www.sec.gov/comments/sr-cboeexus-2018-019/cboeexus2018019-3551361- 162325.pdf. Amendment No. 1 was subsequently replaced and superseded in its entirety by Amendment No. 2. See note 7, infra.