SECURITIES AND EXCHANGE COMMISSION


Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Extend the Exchange’s Penny Pilot Program

June 26, 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 25, 2018, The Nasdaq Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “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

The Exchange proposes to amend Chapter VI, Section 5 (Minimum Increments)3 of the rules of The Nasdaq Options Market (“NOM”) with respect to the maximum price variation for all participating options classes, except for the Nasdaq-100 Index Tracking Stock (“QQQQ”), the SPDR S&P 500 Exchange Traded Fund (“SPY”) and the iShares Russell 2000 Index Fund (“IWM”), to extend the Penny Pilot Program for an additional six months.

The SEC as a rule change for effectiveness upon filing. Until such time as the Board makes a change in the increments, the following principles shall apply:

(a) The Board may establish minimum quoting increments for options contracts traded on NOM. Such minimum increments established by the Board will be set forth below. Proposed new language is italicized and proposed deleted language is in brackets.

The Nasdaq Stock Market Rules
Options Rules

Chapter VI Trading Systems

Sec. 5 Minimum Increments

The Exchange proposes to extend the Penny Pilot through December 31, 2018. The Penny Pilot Program issues that have been delisted may be replaced on the second trading day following the expiration of the Penny Pilot.

The Exchange proposes to extend the Penny Pilot to December 31, 2018.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The purpose of this filing is to amend Chapter VI, Section 5, to extend the Penny Pilot through December 31, 2018 or the date of permanent approval, if earlier,4 and to change the date when delisted classes may be replaced in the Penny Pilot. The Exchange believes that extending the Penny Pilot will allow for further analysis of the Penny Pilot and a determination of how the program should be structured in the future.

Under the Penny Pilot, the minimum price variation for all participating options classes, except for the Nasdaq-100 Index Tracking Stock (“QQQQ”), the SPDR S&P 500 Exchange Traded Fund (“SPY”) and the iShares Russell 2000 Index Fund (“IWM”), is $0.01 for all quotations in options series that are quoted at less than $3 per contract and $0.05 for all quotations in options series that are quoted at $3 per contract or greater. QQQQ, SPY and IWM are quoted in $0.01 increments for all options series. The Penny Pilot is currently scheduled to expire on June 30, 2018.5

The Exchange proposes to extend the time period of the Penny Pilot through December 31, 2018 or the date of permanent approval, if earlier, and to provide a revised date for adding replacement issues to the Penny Pilot.

The Exchange proposes that any Penny Pilot Program issues that have been delisted may be replaced on the second trading day following July 1, 2018. The replacement issues will be selected based on trading activity in the previous six months.6

This filing does not propose any substantive changes to the Penny Pilot Program; all classes currently participating in the Penny Pilot will remain the same and all minimum increments will remain unchanged. The Exchange believes the benefits to public customers and other market participants who will be able to express their true prices to buy and sell options have been demonstrated to outweigh the potential increase in quote traffic.

3 References herein to Chapter and Series refer to rules of the NASDAQ Options Market (“NOM”), unless otherwise noted.

4 The options exchanges in the U.S. that have pilot programs similar to the Penny Pilot (together “pilot programs”) are currently working on a proposal for permanent approval of the respective pilot programs.


6 The replacement issues will be announced to the Exchange’s membership via an Options Trader Alert (OTA) posted on the Exchange’s website. Penny Pilot replacement issues will be selected based on trading activity in the previous six months, as is the case today. The replacement issues would be identified based on The Options Clearing Corporation’s trading volume data. For example, for the July replacement, trading volume from December 1, 2017 through May 31, 2018 would be analyzed. The month immediately preceding the replacement issues’ addition to the Pilot Program (i.e., June) would not be used for purposes of the six-month analysis.
2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,7 in general, and furthers the objectives of Section 6(b)(5) of the Act,8 in particular, that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and 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.

In particular, the proposed rule change, which extends the Penny Pilot for an additional six months through December 31, 2018 or the date of permanent approval, if earlier, and changes the date for replacing Penny Pilot issues that were delisted to the second trading day following July 1, 2018, will enable public customers and other market participants to express their true prices to buy and sell options on the Exchange. This is consistent with the Act.

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. To the contrary, this proposal is pro-competitive because it allows Penny Pilot issues to continue trading on the Exchange.

Moreover, the Exchange believes that the proposed rule change will allow for further analysis of the Pilot and a determination of how the Pilot should become operative prior to 30 days from the date on which it was filed, or such shorter time as the Commission may designate, if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b–4(f)(6)(iii) thereunder.

A proposed rule change filed under Rule 19b–4(f)(6)11 normally does not become operative prior to 30 days after the date of the filing.12 However, pursuant to Rule 19b–4(f)(6)(iii),13 the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has asked the Commission to waive the 30-day operative delay so that the proposal may become operative immediately upon filing. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because doing so will allow the Pilot Program to continue without interruption in a manner that is consistent with the Commission’s prior approval of the extension and expansion of the Pilot Program and will allow the Exchange and the Commission additional time to analyze the impact of the Pilot Program.14 Accordingly, the Commission designates the proposed rule change as operative upon filing with the Commission.15

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)16 of the Act 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 email to rule-comments@sec.gov. Please include File Number SR–NASDAQ–2018–048 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–NASDAQ–2018–048. This file number should be included on the subject line if email 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

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12 17 CFR 240.19b–4(f)(6). In addition, Rule 19b–4(f)(6)(iii) requires the Exchange to give the Commission written notice of the Exchange’s intent to file the proposed rule change along with a brief description and the text of 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 pre-filing requirement.
15 For purposes only of waiving the operative delay for this proposal, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78s(f).
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 self-regulatory organization included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The self-regulatory organization 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 amend BOX Rule 7300 (Preferenced Orders) to provide an additional allocation preference to Preferred Market Makers.

The Exchange will monitor the frequency in which Preferred Market Makers receive the small size order allocation. Specifically, the Exchange will review the proposed provision quarterly and will maintain the small order size at a level that will not allow small size orders executed by Preferred Market Makers to be allocated the small size order allocation preference for the Preferred Market Maker.

2. Statutory Basis

The proposed amendment to BOX Rule 7300 is subject to the following statutory bases:


3. Regulatory Basis

The proposed amendment to BOX Rule 7300 is being promulgated to provide an additional allocation preference to Preferred Market Makers.

The Exchange proposes to amend BOX Rule 7300 (Preferenced Orders) to provide an additional allocation preference to Preferred Market Makers. Specifically, the Exchange is proposing that small size Preferenced Orders will be allocated in full to the Preferred Market Maker, subject to certain conditions described below. Small size orders are defined as five (5) or fewer contracts. In order for the Preferred Market Maker to be allocated the small size order, they must be quoting at the NBBO when they receive the Preferenced Order. As is the case with the current allocation of Preferenced Orders, all orders from the account of Public Customers, if any, will continue to be allocated for execution against the Preferenced Order first. The Preferred Market Maker will only receive the small size order allocation if there are contracts remaining after any Public Order allocation of Preferenced Orders, all orders from the account of Public Customers, if any, will continue to be allocated for execution against the Preferenced Order first. The Preferred Market Maker may only be allocated up to the size of their quote.

The Exchange does not believe the proposal raises any new or novel issues. Currently, the vast majority of options exchanges provide a small lot allocation preference to specialists, with the

1 See Rule 7300(a)(2).  
2 See proposed Rule 7300(e).  
3 Cboe EDGX Rule 21.8(b)(2) provides a small lot allocation preference to Primary Market Makers, Nasdaq ISLE Rule 713.01(c) provides a small lot allocation preference for Primary Market Makers, NYSE American Rule 964.2NY provides a small lot allocation preference to the Primary Specialist, Nasdaq BX Chap. VI, Section 10(c)(2) provides a small lot allocation preference for the Lead Market Maker, Nasdaq GEM (sic) Rule 713.01(c) provides a small lot allocation preference for Primary Market

Preferenced Market Maker must maintain a continuous two-sided market, throughout the trading day, in 99% of the non-adjusted option series of each class for which it accepts Preferenced Orders, for 90% of the time the Exchange is open for trading in each such option class. A Preferred Market Maker is not required to quote in intraday add-on series or series that have a time to expiration of nine months or more in the classes for which it receives Preferenced Orders.

Small Size Orders

The Exchange is now proposing to amend Rule 7300 to provide an additional allocation preference to Preferred Market Makers. Specifically, the Exchange is proposing that small size Preferenced Orders will be allocated in full to the Preferred Market Maker, subject to certain conditions described below. Small size orders are defined as five (5) or fewer contracts. In order for the Preferred Market Maker to be allocated the small size order, they must be quoting at the NBBO when they receive the Preferenced Order. As is the case with the current allocation of Preferenced Orders, all orders from the account of Public Customers, if any, will continue to be allocated for execution against the Preferenced Order first. The Preferred Market Maker will only receive the small size order allocation if there are contracts remaining after any Public Order allocation of Preferenced Orders, all orders from the account of Public Customers, if any, will continue to be allocated for execution against the Preferenced Order first. The Preferred Market Maker may only be allocated up to the size of their quote.

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