

March 20, 2018; *Filing Authority*: 39 CFR 3015.50; *Public Representative*: Curtis E. Kidd; *Comments Due*: March 28, 2018.

This Notice will be published in the **Federal Register**.

Stacy L. Ruble,  
Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-82911; File No. SR-ISE-2017-106]

### Self-Regulatory Organizations; Nasdaq ISE, LLC; Order Granting Approval of a Proposed Rule Change, as Modified by Amendment No. 1, To Permit the Listing and Trading of NQX Index Options on a Pilot Basis

March 20, 2018.

#### I. Introduction

On December 6, 2017, Nasdaq ISE, LLC (“ISE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to permit the listing and trading of options based on  $\frac{1}{5}$  the value of the Nasdaq-100 Index (“Nasdaq-100”) on a pilot basis. The proposed rule change was published for comment in the **Federal Register** on December 26, 2017.<sup>3</sup> On January 31, 2018, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>4</sup> On February 8, 2018, pursuant to Section 19(b)(2) of the Act,<sup>5</sup> the Commission designated a longer period within which to approve the proposed rule change, disapprove

the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change.<sup>6</sup> The Commission received no comment letters on the proposed rule change. The Commission is approving the proposed rule change, as modified by Amendment No. 1, subject to a pilot period set to end on the earlier of: (1) Twelve months following the date of the first listing of the options; or (2) June 30, 2019.

#### II. Description of the Proposal, as Modified by Amendment No. 1

The Exchange is proposing to amend its rules to permit the listing and trading, on a pilot basis, of index options on the Nasdaq 100 Reduced Value Index (“NQX”) with third Friday of the month expiration dates. The Exchange represents that the NQX options contract will be the same in all respects as the current Nasdaq-100 (“NDX”) options contract listed on the Exchange,<sup>7</sup> except that it will be based on  $\frac{1}{5}$  of the value of the Nasdaq-100, and will be P.M.-settled with an exercise settlement value based on the closing index value of the Nasdaq-100 on the day of expiration.<sup>8</sup> In particular, NQX options will be subject to the same rules that presently govern the trading of index options based on the Nasdaq-100, including sales practice rules, margin requirements, trading rules, and position and exercise limits. Similar to NDX options, NQX options will be European-style and cash-settled, and will have a contract multiplier of 100. NQX options will have a minimum trading increment of \$0.05 for options below \$3.00 and \$0.10 for all other series. Strike price intervals will be set at \$1 or greater, subject to conditions described in ISE Rule 2009(c)(5).<sup>9</sup>

<sup>6</sup> See Securities Exchange Act Release No. 82666, 83 FR 6626 (February 14, 2018). The Commission designated March 26, 2018 as the date by which the Commission shall approve or disapprove, or institute proceedings to determine whether to approve or disapprove, the proposed rule change.

<sup>7</sup> See Securities Exchange Act Release No. 51121 (February 1, 2005), 70 FR 6476 (February 7, 2005) (SR-ISE-2005-01).

<sup>8</sup> The Exchange notes that similar features are available with other index options contracts listed on the Exchange and other options exchanges, including options contracts based on  $\frac{1}{10}$  the value of the Nasdaq-100 (“MNX”) and P.M.-settled options on the full value of the Nasdaq-100 (“NDXPM”). See Notice, *supra* note 3, at 61091.

<sup>9</sup> Generally, pursuant to ISE Rule 2009(c)(1), index options listed on the Exchange are subject to strike price intervals of no less than \$5, provided that certain classes of index options (including NDX and MNX) have strike price intervals of no less than \$2.50 if the strike price is less than \$200. The Exchange proposes to amend ISE Rule 2009(c)(1) to add NQX options to the list of classes where strike price intervals of no less than \$2.50 are generally permitted if the strike price is less than \$200. In addition, ISE Rule 2009(c)(5) provides finer strike

Consistent with the Exchange’s existing rules for index options, the Exchange will allow up to six expiration months at any one time that may expire at three-month intervals or in consecutive months, as well as LEAPS.<sup>10</sup> The product will have European-style exercise and will not be subject to position limits, although the Exchange proposes to amend ISE Rule 2004(c) to more accurately describe how positions in reduced-value options would be aggregated with full-value options.<sup>11</sup>

As proposed, NQX would become subject to a pilot for a period that would end on the earlier of: (i) Twelve months following the date of the first listing of the options; or (ii) June 30, 2019 (“Pilot Program”). If the Exchange were to propose an extension of the Pilot Program or should the Exchange propose to make the Pilot Program permanent, then the Exchange would submit a filing proposing such amendments to the Pilot Program. The Exchange notes that any positions established under the pilot would not be impacted by the expiration of the pilot. For example, a position in an NQX options series that expires beyond the conclusion of the pilot period could be established during the pilot. If the Pilot Program were not extended, then the position could continue to exist. However, the Exchange notes that any further trading in the series would be restricted to transactions where at least one side of the trade is a closing transaction.

The Exchange proposes to submit a Pilot Program report to Commission at least two months prior to the expiration date of the Pilot Program (the “annual report”). The annual report would contain an analysis of volume, open interest, and trading patterns. The analysis would examine trading in the

price intervals for MNX options as these contracts are based on a reduced value of the Nasdaq-100.

Specifically, ISE Rule 2009(c)(5) provides that notwithstanding ISE Rule 2009(c)(1), the interval between strike prices of series of MNX options will be \$1 or greater, subject to certain conditions. The Exchange proposes to adopt the same strike price intervals for NQX options as currently approved for MNX options. The Exchange will not list LEAPS on NQX options at intervals less than \$5. If the Exchange determines to add NQX options to the Weeklies or Quarterlies programs, such options will be listed with the expirations and strike prices described in Supplementary Material .01 or .02 to ISE Rule 2009. The Exchange notes that it expects to add NQX options to the Weeklies program. See *id.* at 61092 n.15.

<sup>10</sup> See *id.* at 61092 & n.13. The Exchange states that it intends to file a separate proposed rule change to modify the expiration months permitted for index option contracts consistent with Nasdaq PHLX LLC (“Phlx”) Rule 1101A(b). See *id.* at 61092 n.13.

<sup>11</sup> For a more detailed description of the proposed NQX contract, see Notice, *supra* note 3.

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 82362 (December 19, 2017), 82 FR 61090 (“Notice”).

<sup>4</sup> In Amendment No. 1, the Exchange revised its proposal to: (1) Add that raw percentage price change data as well as percentage price change data normalized for prevailing market volatility, as measured by an appropriate index as agreed by the Commission and the Exchange, would be provided as part of the pilot data; and (2) revise the proposed duration of the pilot program such that the pilot would terminate on the earlier of: (i) Twelve months following the date of the first listing of the options; or (ii) June 30, 2019. When the Exchange filed Amendment No. 1 with the Commission, it also submitted Amendment No. 1 to the public comment file for SR-ISE-2017-106 (available at: <https://www.sec.gov/comments/sr-ise-2017-106/ise2017106.htm>). Because Amendment No. 1 does not materially alter the substance of the proposed rule change or raise unique or novel regulatory issues, it is not subject to notice and comment.

<sup>5</sup> 15 U.S.C. 78s(b)(2).

proposed option product as well as trading in the securities that comprise the Nasdaq-100. In addition, for series that exceed certain minimum open interest parameters, the annual report would provide analysis of index price volatility and share trading activity. In addition to the annual report, the Exchange would provide the Commission with periodic interim reports while the Pilot Program is in effect that would contain some, but not all, of the information contained in the annual report. The annual report would be provided to the Commission on a confidential basis. The annual report would contain the following volume and open interest data:

- (1) Monthly volume aggregated for all trades;
- (2) monthly volume aggregated by expiration date;
- (3) monthly volume for each individual series;
- (4) month-end open interest aggregated for all series;
- (5) month-end open interest for all series aggregated by expiration date; and
- (6) month-end open interest for each individual series.

In addition to the annual report, the Exchange would provide the Commission with interim reports of the information listed in Items (1) through (6) above periodically as required by the Commission while the Pilot Program is in effect. These interim reports would also be provided on a confidential basis.

Finally, the annual report would contain the following analysis of trading patterns in Expiration Friday, P.M.-settled NQX option series in the Pilot Program: (1) A time series analysis of open interest; and (2) an analysis of the distribution of trade sizes. Also, for series that exceed certain minimum parameters, the annual report would contain the following analysis related to index price changes and underlying share trading volume at the close on Expiration Fridays: A comparison of index price changes at the close of trading on a given Expiration Friday with comparable price changes from a control sample. The data would include a calculation of percentage price changes for various time intervals and compare that information to the respective control sample. Raw percentage price change data as well as percentage price change data normalized for prevailing market volatility, as measured by an appropriate index as agreed by the Commission and the Exchange, would be provided. The Exchange would provide a calculation of share volume for a sample set of the component securities representing an upper limit

on share trading that could be attributable to expiring in-the-money series. The data would include a comparison of the calculated share volume for securities in the sample set to the average daily trading volumes of those securities over a sample period. The minimum open interest parameters, control sample, time intervals, method for randomly selecting the component securities, and sample periods would be determined by the Exchange and the Commission.<sup>12</sup>

### III. Discussion and Commission Findings

After careful consideration of the proposal, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange,<sup>13</sup> and, in particular, the requirements of Section 6 of the Act.<sup>14</sup> Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>15</sup> which requires that an exchange have rules designed to remove impediments to and perfect the mechanism of a free and open market and to protect investors and the public interest, to allow ISE to conduct a limited, and carefully monitored, pilot as proposed.

The Commission notes that it has previously approved the listing and trading of options based on a reduced value of the Nasdaq-100.<sup>16</sup> However, this proposed rule change would permit P.M. settlement for such options and, as noted in the Commission's order approving the listing and trading of NDXPM on Phlx on a pilot program basis, the Commission has had concerns about the potential adverse effects and impact of P.M. settlement upon market volatility and the operation of fair and orderly markets on the underlying cash market at or near the close of trading, including for cash-settled derivatives contracts based on a broad-based index.<sup>17</sup> The potential impact today

remains unclear, given the significant changes in the closing procedures of the primary markets in recent decades. The Commission is mindful of the historical experience with the impact of P.M. settlement of cash-settled index derivatives on the underlying cash markets, but recognizes that these risks may be mitigated today by the enhanced closing procedures that are now in use at the primary equity markets.

Additionally, for the reasons described below, the Commission believes that ISE's proposed NQX Pilot Program is designed to mitigate concerns regarding P.M. settlement and will provide additional trading opportunities for investors while providing the Commission with data to monitor the effects of NQX options and the impact of P.M. settlement on the markets. To assist the Commission in assessing any potential impact of a P.M.-settled NQX option on the options markets as well as the underlying cash equities markets, ISE will be required to submit data to the Commission in connection with the Pilot Program. The Commission believes that ISE's proposed Pilot Program, together with the data and analysis that ISE will provide to the Commission, will allow ISE and the Commission to monitor for and assess any potential for adverse market effects of allowing P.M. settlement for NQX options, including on the underlying component stocks. In particular, the data collected from ISE's NQX Pilot Program will help inform the Commission's consideration of whether the Pilot Program should be modified, discontinued, extended, or permanently approved. Furthermore, the Exchange's ongoing analysis of the Pilot Program should help it monitor any potential risks from large P.M.-settled positions and take appropriate action on a timely basis if warranted.

The Exchange represents that it has adequate surveillance procedures to monitor trading in these options thereby helping to ensure the maintenance of a fair and orderly market, and has represented that it has sufficient capacity to handle additional traffic associated with this new listing.<sup>18</sup>

<sup>12</sup> See *id.* at 61092–93 and Amendment No. 1. The proposed Pilot Program for NQX options is similar to the pilot program approved for the listing and trading of NDXPM options on Phlx. See Securities Exchange Act Release No. 81293 (Aug. 2, 2017), 82 FR 37138 (Aug. 8, 2017) (“NDXPM Order”).

<sup>13</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>14</sup> 15 U.S.C. 78f.

<sup>15</sup> 15 U.S.C. 78f(b)(5).

<sup>16</sup> See, e.g., Securities Exchange Act Release Nos. 57654 (April 11, 2008), 73 FR 21003 (April 17, 2008); 51121 (February 1, 2005), 70 FR 6476 (February 7, 2005).

<sup>17</sup> See NDXPM Order, *supra* note 12. See also Securities Exchange Act Release Nos. 64599 (June

3, 2011), 76 FR 33798, 33801–02 (June 9, 2011) (order instituting proceedings to determine whether to approve or disapprove a proposed rule change to allow the listing and trading of SPXPM options); 65256 (September 2, 2011), 76 FR 55969, 55970–76 (September 9, 2011) (order approving proposed rule change to establish a pilot program to list and trade SPXPM options); and 68888 (February 8, 2013), 78 FR 10668, 10669 (February 14, 2013) (order approving the listing and trading of SPXPM on CBOE).

<sup>18</sup> See Notice, *supra* note 3, at 61092. In addition, the Commission notes that ISE would have access

For the reasons discussed above, the Commission finds that ISE's proposal is consistent with the Act, including Section 6(b)(5) thereof, in that it is designed to remove impediments to and perfect the mechanism of a free and open market, and, in general, to protect investors and the public interest. In light of the enhanced closing procedures at the underlying markets and the potential benefits to investors discussed by the Exchange in the Notice,<sup>19</sup> the Commission finds that it is appropriate and consistent with the Act to approve ISE's proposal on a pilot basis. The collection of data during the Pilot Program and ISE's active monitoring of any effects of NQX options on the markets will help ISE and the Commission assess any impact of P.M. settlement in today's market.

#### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>20</sup> that the proposed rule change (SR-ISE-2017-106), as modified by Amendment No. 1, be, and hereby is, approved, subject to a pilot period set to expire on the earlier of: (1) Twelve months following the date of the first listing of the options; or (2) June 30, 2019.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>21</sup>

**Eduardo A. Aleman,**  
Assistant Secretary.

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to information through its membership in the Intermarket Surveillance Group with respect to the trading of the securities underlying the NQX, as well as tools such as large options positions reports to assist its surveillance of NQX options. In approving the proposed rule change, the Commission also has relied upon the Exchange's representation that it has the necessary systems capacity to support new options series that will result from this proposal. *See id.*

<sup>19</sup> *See id.*

<sup>20</sup> 15 U.S.C. 78s(b)(2).

<sup>21</sup> 17 CFR 200.30-3(a)(12).

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-82910; File No. SR-NSCC-2017-018]

### Self-Regulatory Organizations; National Securities Clearing Corporation; Order Instituting Proceedings To Determine Whether To Approve or Disapprove a Proposed Rule Change To Amend the Loss Allocation Rules and Make Other Changes

March 20, 2018.

#### I. Introduction

On December 18, 2017, National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> proposed rule change SR-NSCC-2017-018 to amend the loss allocation rules and make other changes ("Proposed Rule Change").<sup>3</sup> The Proposed Rule Change was published for comment in the **Federal Register** on January 8, 2018.<sup>4</sup> The Commission did not receive any comments on the Proposed Rule Change. On February 8, 2018, pursuant to Section 19(b)(2)(A)(ii)(I) of the Act,<sup>5</sup> the Commission designated a longer period within which to approve, disapprove, or institute proceedings to determine whether to approve or disapprove the Proposed Rule Change.<sup>6</sup> This order institutes proceedings, pursuant to Section 19(b)(2)(B) of the Act,<sup>7</sup> to determine whether to approve or disapprove the Proposed Rule Change.

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> On December 18, 2017, NSCC filed this proposal as an advance notice (SR-NSCC-2017-806) with the Commission pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act") and Rule 19b-4(n)(1)(i) of the Act ("Advance Notice"). On January 24, 2018, the Commission extended the review period of the Advance Notice for an additional 60 days pursuant to Section 806(e)(1)(H) of the Clearing Supervision Act. *See* 12 U.S.C. 5465(e)(1); 17 CFR 240.19b-4(n)(1)(i); 12 U.S.C. 5465(e)(1)(H); and Securities Exchange Act Release No. 82584 (January 24, 2018), 83 FR 4377 (January 30, 2018) (SR-NSCC-2017-806).

<sup>4</sup> Securities Exchange Act Release No. 82428 (January 2, 2018), 83 FR 897 (January 8, 2018) (SR-NSCC-2017-018) ("Notice").

<sup>5</sup> 15 U.S.C. 78s(b)(2)(A)(ii)(I).

<sup>6</sup> Securities Exchange Act Release No. 82670 (February 8, 2018), 83 FR 6626 (February 14, 2018) (SR-DTC-2017-022; SR-FICC-2017-022; SR-NSCC-2017-018).

<sup>7</sup> 15 U.S.C. 78s(b)(2)(B).

## II. Summary of the Proposed Rule Change<sup>8</sup>

As described in the Notice,<sup>9</sup> NSCC proposes to revise its Rules and Procedures to primarily change (i) the loss allocation process,<sup>10</sup> (ii) the loss allocation governance for Declared Non-Default Loss Events,<sup>11</sup> and (iii) the retention time for the Actual Deposit of former members.<sup>12</sup>

#### A. Loss Allocation Process

NSCC states that it would retain the current core loss allocation process.<sup>13</sup> However, NSCC proposes to revise certain elements and introduce certain new loss allocation concepts, by making five key changes to its loss allocation process.

First, NSCC proposes to replace the calculation of its corporate contribution from no less than 25 percent of its retained earnings or such higher amount as the Board of Directors shall determine to a defined Corporate Contribution.<sup>14</sup> The proposed Corporate Contribution would be defined as an amount equal to 50 percent of NSCC's General Business Risk Capital Requirement.<sup>15</sup> NSCC's General Business Risk Capital Requirement is, at a minimum, equal to the regulatory capital that NSCC is required to maintain in compliance with Rule 17Ad-22(e)(15) under the Act.<sup>16</sup> In addition, NSCC proposes to mandatorily apply Corporate Contribution (i) prior to a loss allocation among Members, and (ii) to losses arising from both Defaulting Member Events and Declared Non-Default Loss Events.<sup>17</sup>

Second, NSCC proposes to introduce an Event Period to address the allocation of losses and liabilities that may arise from or relate to multiple

<sup>8</sup> The Commission notes that the Summary of the Proposed Rule Change section does not describe the Proposed Rule Change in its entirety. Other changes include, but are not limited to, the clarification of defined terms, various aspects of the Clearing Fund application, and detailed procedures of the loss allocation. The complete Proposed Rule Change can be found in the Notice. *See* Notice, *supra* note 4. In addition, the text of the Proposed Rule Change is available at <http://www.dtcc.com/legal/rules-and-procedures.aspx>.

<sup>9</sup> The description of the Proposed Rule Change herein is based on the statements prepared by NSCC in the Notice. *See* Notice, *supra* note 4. Each capitalized term not otherwise defined herein has its respective meaning either (i) as set forth in the Rules and Procedures of NSCC, available at <http://www.dtcc.com/legal/rules-and-procedures.aspx>, or (ii) as set forth in the Notice.

<sup>10</sup> *See* Notice, *supra* note 4, at 898-901.

<sup>11</sup> *See id.* at 901.

<sup>12</sup> *See id.* at 901-02.

<sup>13</sup> *Id.* at 898.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*; 17 CFR 240.17Ad-22(e)(15).

<sup>17</sup> Notice, *supra* note 4, at 898.