SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-99825; File No. SR-ISE-2024-12)

March 21, 2024

Self-Regulatory Organizations; Nasdaq ISE, LLC; Notice of Filing of Proposed Rule Change to Adopt Rules to List and Trade FLEX Options

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 March 11, 2024, Nasdaq ISE, LLC ("ISE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III, 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 adopt rules that will govern the listing and trading of flexible exchange options ("FLEX Options").

The text of the proposed rule change is available on the Exchange's Website at https://listingcenter.nasdaq.com/rulebook/ise/rules, at the principal office of the Exchange, and at the Commission's Public Reference Room.

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

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

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 adopt rules in new Options 3A that will govern the listing and trading of FLEX Options on the Exchange's electronic market.

The Exchange is proposing this new functionality be implemented in connection with a technology migration to enhanced Nasdaq, Inc. ("Nasdaq") functionality that will result in higher performance, scalability, and more robust architecture.[3] The Exchange intends to begin implementation of the proposed rule change before December 20, 2024. The Exchange will issue a public notice to Members to provide notification of the FLEX implementation date.

As proposed, FLEX Options will be customized options contracts that will allow investors to tailor contract terms for exchange-listed equity and index options. FLEX Options will be designed to meet the needs of investors for greater flexibility in selecting the terms of options within the parameters of the Exchange's proposed rules. FLEX Options will not be preestablished for trading and will not be listed individually for trading on the Exchange. Rather, investors will select FLEX Option terms and will be limited by the parameters detailed below in their selection of those terms. As a result, FLEX Options would allow investors to specify more specific, individualized investment objectives than may be available to them in the standardized options market.

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3 The Exchange is separately proposing a number of rule filings in connection with this technology migration. See, e.g., Securities Exchange Act Release No. 97605 (May 26, 2023), 88 FR 36350 (June 2, 2023) (SR-ISE-2023-10).

Some key features of the new electronic FLEX Options functionality are as follows:

- **System Availability**: The Exchange will not conduct an Opening Process pursuant to Options 3, Section 8 in FLEX Options.[4] Orders in FLEX Options may only be submitted through an electronic FLEX Auction, a FLEX Price Improvement Auction ("FLEX PIM"), or a FLEX Solicited Order Mechanism ("FLEX SOM"), each as discussed in detail below.[5] Accordingly, the Exchange's simple and complex order books will not be available for transactions in FLEX Options.[6]
- **Terms**: FLEX Options will be a type of put or call, and will allow investors the flexibility to choose an exercise style of American or European, an expiration date, a settlement type, and an exercise price, all within the parameters specified in the proposed rules.[7] As discussed further below, FLEX Options will not be permitted with identical terms as an existing non-FLEX Option series listed on the Exchange.[8]

Because of their composition, the Exchange believes that FLEX Options may allow investors to more closely meet their individual investment and hedging objectives by customizing options contracts for the purpose of satisfying particular investment objectives that could not be met by the standardized markets.

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4 See proposed Options 3A, Section 8(a). Rather, Members may begin submitting orders in FLEX Options into one of the proposed auction mechanisms (i.e., electronic FLEX Auction, FLEX Price Improvement Mechanism, and FLEX Solicited Order Mechanism) once the underlying security is open for trading. See proposed Options 3A, Section 8(b).

5 See proposed Options 3A, Section 11(a).

6 See proposed Options 3A, Section 10(a).

7 As discussed later in this filing, proposed Options 3A, Section 3(c) will govern FLEX Options terms.

8 At least one of the following terms must differ between FLEX Options and non-FLEX Options on the same underlying security: exercise date, exercise price, or exercise style. See proposed Options 3A, Section 3(c).

Background

The Commission approved the trading of FLEX Options in 1993.[9] At the time, the Chicago Board Options Exchange, Inc., now Cboe Exchange, Inc. ("Cboe") proposed FLEX options based on the Standard and Poor's Corporation 500 and 100 Stock Indexes.[10] These FLEX Options were offered as an alternative to an over-the-counter ("OTC") market in customized equity options.[11] Several years after the initial approval, the Commission approved the trading of additional FLEX Options on specified equity securities.[12] In its order, the Commission provided: "The benefits of the Exchanges' options markets include, but are not limited to, a centralized market center, an auction market with posted transparent market quotations and transaction reporting, parameters and procedures for clearance and settlement, and the guarantee of the OCC [Options Clearing Corporation] for all contracts traded on the Exchange."[13]

The Exchange notes that FLEX Options are currently traded on Cboe, NYSE American LLC ("NYSE American"), NYSE Arca, Inc. ("NYSE Arca"), and Nasdaq PHLX LLC ("Phlx").[14] The Exchange further notes that Cboe offers electronic and open outcry FLEX

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9 See Securities Exchange Act Release No. 31920 (February 24, 1993), 58 FR 12280 (March 3, 1993) (SR-CBOE-92-17) (Order Approving and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 1, 2, 3, and 4 to Proposed Rule Changes by the Chicago Board Options Exchange, Inc., Relating to FLEX Options).

10 Id.

11 Id.

12 See Securities Exchange Act Release No. 36841 (February 14, 1996), 61 FR 6666 (February 21, 1996) (SR-CBOE-95-43) (SR-PSE-95-24) (Order Approving Proposed Rule Changes and Notice of Filing and Order Granting Accelerated Approval of Amendments by the Chicago Board Options Exchange, Inc. and the Pacific Stock Exchange, Inc., Relating to the Listing of Flexible Exchange Options on Specified Equity Securities).

13 Id. The Exchange notes that the Commission found pursuant to Rule 9b-1 under the Act, that FLEX Options, including FLEX Equity Options, are standardized options for purposes of the options disclosure framework established under Rule 9b-1 of the Act. Id.

14 See Cboe Rules 4.20-4.22 and 5.70-5.75, NYSE American Rules 900G-910G, NYSE Arca Rules 5.30-O-5.41-O, and Phlx Options 8, Section 34. The Exchange also notes that another options exchange, BOX

Options trading while NYSE American, NYSE Arca, and Phlx offer only open outcry trading of FLEX Options on their respective trading floors. The Exchange now proposes to allow for the trading of FLEX Options on its electronic market[15] in a substantially similar manner as Cboe's electronic FLEX Options, with certain intended differences primarily to align to current System[16] behavior (and especially current auction behavior) to provide increased consistency for Members trading FLEX Options and non-FLEX Options on ISE, as discussed in detail below. Further, the Exchange has omitted certain Cboe rules from the proposed rules due to differences in scope and operation of FLEX trading at Cboe compared to the proposed scope and operation of FLEX trading on ISE, each as noted below. For example, the Exchange will not include Cboe rule provisions related to open outcry trading, Asian- or Cliquet-settled FLEX index options, or FLEX index options with an index multiplier of one ("Micro FLEX Index Options") as it does not offer these capabilities today. For the same reason, the Exchange will not allow prices in FLEX trading to be expressed as percentages under this proposal.

Proposal

Transactions in FLEX Options traded on the Exchange will generally be subject to the same rules that apply to the trading of equity options and index options. In order, however, to provide investors with the flexibility to designate certain of the terms of the options, and to accommodate other special features of FLEX Options and the way in which they are traded, the Exchange proposes new rules applicable to FLEX Options in new Options 3A, Sections 1 – 19.

Exchange LLC ("BOX"), recently filed a rule change with the Commission to allow for the trading of FLEX equity options on the BOX trading floor. See Securities Exchange Act Release No. 99192 (December 15, 2023), 88 FR 88437 (December 21, 2023) (SR-BOX-2023-20).

15 The Exchange is not proposing to add open outcry FLEX Options trading as it does not have a trading floor.

16 The term "System" means the electronic system operated by the Exchange that receives and disseminates quotes, executes orders and reports transactions. See Options 1, Section 1(a)(50).

A. General Provisions (Section 1)

Proposed Section 1(a) will set forth the applicability of Exchange Rules, and will provide that Options 3A Rules will apply only to FLEX Options and that trading of FLEX Options will be subject to all other Rules applicable to the trading of options on the Exchange, unless otherwise provided in Options 3A.

Proposed Section 1(b) will set forth the definitions used specifically in Options 3A, namely that the term "FLEX Option" means a flexible exchange option. A FLEX Option on an equity security may be referred to as a "FLEX Equity Option," and a FLEX Option on an index may be referred to as a "FLEX Index Option." Further, the term "FLEX Order" means an order submitted in a FLEX Option pursuant to Options 3A.

The Exchange also proposes to add the definition of "FLEX Order" in Options 3, Section 7 (Order Types) in new paragraph (z). While FLEX Orders will also be defined in (and governed by) Options 3A, the Exchange believes that it will be useful to market participants to have the order types available on ISE centralized within one rule. Lastly, the Exchange proposes a non-substantive change to paragraph (y) in Options 3, Section 7 to fix a typo.

B. Hours of Business (Section 2)

Proposed Section 2(a) will provide that the trading hours for FLEX Options will be the same as the trading hours for corresponding non-FLEX Options as set forth in Options 3, Section 1, except the Exchange may determine to narrow or otherwise restrict the trading hours for FLEX Options.[17] Therefore, the trading hours for FLEX Options will generally be 9:30 a.m. to 4:00 p.m. Eastern time (or 4:15 p.m. Eastern time for Fund Shares, as defined in Options 4,

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[17] See Cboe Rule 5.1(b)(3)(A) for materially identical provisions.

Section 3(h), Index-Linked Securities, as defined in Options 4, Section 3(k)(1), or certain broad-based indexes).[18]

C. FLEX Option Classes and Permissible Series (Section 3(a) and (b))

Pursuant to proposed Section 3(a), the Exchange may authorize for trading a FLEX Option class on any equity security or index if it may authorize for trading a non-FLEX Option class on that equity security or index pursuant to Options 4, Section 3 and Options 4A, Section 3,[19] respectively, even if the Exchange does not list that non-FLEX Option class for trading.[20]

Proposed Section 3(b) will provide that the Exchange may approve a FLEX Option series for trading in any FLEX Option class it may authorize for trading pursuant to proposed Section 3(a). FLEX Option series are not pre-established. A FLEX Option series is eligible for trading on the Exchange upon submission to the System of a FLEX Order for that series pursuant to proposed Sections 11 through 13,[21] subject to the following stipulations.[22] First, the Exchange will only permit trading in a put or call FLEX Option series that does not have the same exercise style, same expiration date, and same exercise price as a non-FLEX Option series on the same underlying security or index that is already available for trading. This would include permitting trading in a FLEX Option series before a series with identical terms is listed for trading as a non-FLEX Option series. If the Exchange lists for trading a non-FLEX Option series with identical terms as a FLEX Option series, the FLEX Option series will become fungible with the non-

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18 See Options 3, Section 1(c) – (e).

19 Options 4, Section 3 provides the criteria for the listing of options on several different underlying types of securities, including, for example, securities registered with the SEC under Regulation NMS of the Act ("NMS stock") and exchange-traded funds ("ETFs"). Options 4A, Section provides the criteria for the listing of options on indexes.

20 See Cboe Rule 4.20 for materially identical provisions.

21 Proposed Sections 11 through 13 of Options 3A will govern the electronic FLEX Auction, FLEX PIM, and FLEX SOM, respectively. As discussed later in this filing, FLEX Orders may only be submitted through an electronic FLEX Auction, FLEX PIM, or FLEX SOM.

22 See proposed Options 3A, Section 3(b), which is based on Cboe Rule 4.21(a).

FLEX Option series pursuant to proposed paragraph (d) of Section 3. The System would not accept a FLEX Order for a put or call FLEX Option series if a non-FLEX Option series on the same underlying security or index with the same expiration date, exercise price, and exercise style is already listed for trading.[23] Second, a FLEX Order for a FLEX Option series may be submitted on any trading day prior to the expiration date.[24]

D. FLEX Options Terms (Section 3(c))

Proposed Section 3(c) will specify the terms that must be included in a FLEX Order.[25] Specifically, when submitting a FLEX Order for a FLEX Option series to the System, the submitting Member must include one of each of the terms detailed in proposed subparagraphs (1) – (6) of Section 3(c) in the FLEX Order (all other terms of a FLEX Option series are the same as those that apply to non-FLEX Options), provided that a FLEX Equity Option overlying an ETF (cash- or physically-settled) may not be the same type (put or call) and may not have the same exercise style, expiration date, and exercise price as a non-FLEX Equity Option overlying the same ETF,[26] which terms constitute the FLEX Option series.

As proposed, the submitting Member must specify the following terms in the FLEX Order: (1) underlying equity security or index, as applicable (the index multiplier for FLEX

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23 See proposed Options 3A, Section 3(b)(1), which is based on Cboe Rule 4.21(a)(1).

24 See proposed Options 3A, Section 3(b)(2), which is based on Cboe Rule 4.21(a)(2).

25 See Cboe Rule 4.21(b) for similar provisions. The Exchange notes that unlike Cboe, it is not proposing FLEX Index Options with a multiplier of 1 (i.e., Micro FLEX Index Options) or FLEX Index Options that are Asian- or Cliquet-settled as the Exchange does not have these capabilities today for index options. For the same reason, the Exchange is not proposing to allow exercise prices to be expressed as a percentage value. Therefore, the Exchange has not incorporated the applicable provisions in this Rule.

26 The Exchange will discuss cash-settled FLEX Equity Options overlying an ETF ("cash-settled FLEX ETFs") later in this filing. As discussed below, the Commission previously approved a rule filing by NYSE American to permit the listing and trading of this product, and Cboe recently filed an immediately effective rule change based on NYSE American's filing. See infra notes 186 and 187.

Index Options is 100;[27] (2) type of option (i.e., put or call);[28] (3) exercise style, which may be American-style or European-style;[29] (4) expiration date, which may be any business day (specified to the day, month, and year) no more than 15 years from the date on which a Member submits a FLEX Order to the System;[30] (5) settlement type for the FLEX Equity Option or FLEX Index Option, as applicable;[31] and (6) exercise price, which may be in increments no smaller than $0.01.[32] Further, the Exchange may determine the smallest increment for exercise prices of FLEX Options on a class-by-class basis.[33]

As it relates to the settlement type for FLEX Equity Options, the Exchange proposes in subparagraph (c)(5)(A)(i) of Options 3A, Section 3 that FLEX Equity Options, other than as permitted in proposed subparagraphs (c)(5)(A)(ii) and (iii), are settled with physical delivery of the underlying security. Proposed subparagraph (c)(5)(A)(ii) will allow for the cash-settlement of certain qualifying FLEX Equity Options with an underlying security that is an ETF.[34]

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27 See proposed Options 3A, Section 3(c)(1), which is based on Cboe Rule 4.21(b)(1) except for the provisions relating to Micro FLEX Index Options.

28 See proposed Options 3A, Section 3(c)(2), which is based on Cboe Rule 4.21(b)(2) except the provisions related to Asian-settled or Cliquet-settled FLEX Index Options.

29 See proposed Options 3A, Section 3(c)(3), which is based on Cboe Rule 4.21(b)(3) except with respect to Asian-settled or Cliquet-settled FLEX Index Options.

30 See proposed Options 3A, Section 3(c)(4), which is based on Cboe Rule 4.21(b)(4) except with respect to Asian-settled or Cliquet-settled FLEX Index Options.

31 See proposed Options 3A, Section 3(c)(5), which is based on Cboe Rule 4.21(b)(5) except with respect to Asian-settled or Cliquet-settled FLEX Index Options.

32 See proposed Options 3A, Section 3(c)(6), which is based on Cboe Rule 4.21(b)(6) except the Exchange is not proposing Cliquet-settled Index Options or to allow exercise prices to be expressed as a percentage value.

33 See proposed Options 3A, Section 3(c), which is based on Cboe Rule 4.21(b) except for the provisions allowing the exercise price to be expressed as a percentage amount and with respect to Micro FLEX Index Options. As noted above, the Exchange does not offer these capabilities today for non-FLEX index options.

34 As discussed later in this filing, the Exchange is proposing to list and trade cash-settled FLEX ETFs in the same manner as NYSE American and Cboe.

Proposed subparagraph (c)(5)(A)(iii) will provide that FLEX Equity Options are subject to the exercise by exception provisions of OCC Rule 805.

As it relates to the settlement type for FLEX Index Options, the Exchange proposes in subparagraphs (c)(5)(B)(i) and (ii) of Options 3A, Section 3 that FLEX Index Options are settled in U.S. dollars, and may be either a.m.-settled (with exercise settlement value determined by reference to the reported level of the index derived from the reported opening prices of the component securities) or p.m.-settled (with exercise settlement value determined by reference to the reported level of the index derived from the reported closing prices of the component securities). The Exchange notes that Cboe recently received approval of its pilot program that permitted it to list p.m.-settled FLEX Index Options whose exercise settlement value is derived from closing prices on the last trading day prior to expiration that expire on or within two business days of a third Friday-of-the-month expiration day for a non-FLEX Option ("FLEX PM Third Friday Options").[35] Consistent with the Commission's approval of Cboe's proposal, the Exchange is proposing to allow the listing of FLEX PM Third Friday Options on ISE as well, and will align proposed Section 3(c)(5)(B)(ii) with Cboe Rule 4.21(b)(5)(B)(ii).

E. FLEX Fungibility (Section 3(d))

Proposed Section 3(d)(1)(A) will provide that if the Exchange lists for trading a non-FLEX Option series with identical terms as a FLEX Option series, all existing open positions established under the FLEX trading procedures will become fully fungible with transactions in

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[35] See Securities Exchange Act Release No. 99222 (December 21, 2023), 88 FR 89771 (December 28, 2023) (SR-CBOE-2023-018) ("FLEX Settlement Pilot Approval"). In support of making the pilot a permanent program, Cboe cited to its own review of pilot data during the course of the pilot program and a study by the Commission's Division of Economic and Risk Analysis ("DERA") staff. See FLEX Settlement Pilot Approval, notes 18 and 35.

the identical non-FLEX Option series.[36] In addition, proposed Section 3(d)(1)(B) will provide that any further trading in the series would be as non-FLEX Options subject to non-FLEX trading procedures and Rules.[37] The foregoing provisions are materially identical to Cboe Rule 4.22(a)(1) and (2).

Unlike Cboe, however, the Exchange will not permit intraday additions of a non-FLEX Option series with identical terms as an already-listed FLEX Option series for the remainder of the trading day.[38] As a result, the Exchange will not incorporate the provisions in Cboe Rule 4.22(b) that relate to allowing closing only transactions for FLEX Option series that become fungible with identical non-FLEX Option series.

Lastly, in the event the relevant expiration is a holiday pursuant to General 3, Rule 1030,[39] proposed Section 3(d) will apply to options with an expiration date that is the business day immediately preceding the holiday, except for Monday-expiring Weekly Expirations (as defined in Options 4A, Section 3), in which case proposed Section 3(d) will apply to options with an expiration date that is a business day immediately following the holiday.[40]

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36 An open position resulting from a transaction on the Exchange becomes fungible post-trade and is separate from the execution occurring on the Exchange. For example, assume a Member buys one (1) American style AAPL call option expiring on October 9, 2024, with a strike price of 150, which is a FLEX series because there is no standard option listed with those same terms. Now assume, while holding this position, a standard option with the same terms is listed (American style AAPL call option expiring on October 9, 2024, with a strike price of 150). After this standard option is listed, the Member purchases one (1) contract in this non-FLEX option series. After this second transaction, the Participant will have an open position of two (2) contracts in the standard AAPL call expiring on October 9, 2024, with a 150 strike price.

37 This includes all priority and trade-through provisions on the Exchange. See, e.g., Options 3, Section 10 and Options 5, Section 2.

38 See proposed Options 3A, Section 3(d)(2). In such instances, the non-FLEX Option series could be added overnight to begin trading the next trading day (upon which all existing open positions in the FLEX Option would become fully fungible with transactions in the identical non-FLEX Option series, and any further trading in the series would be as non-FLEX Options subject to non-FLEX trading procedures and Rules).

39 ISE General 3 (including Rule 1030) incorporates by reference Series 1000 of the Rules of The Nasdaq Stock Market, LLC ("Nasdaq").

40 See proposed Options 3A, Section 3(d)(3), which is based on Cboe Rule 4.22(c).

F. Units of Trading; Minimum Trading Increments (Sections 4 and 5)

Proposed Section 4(a) of Options 3A will provide that bids and offers for FLEX Options must be expressed in U.S. dollars and decimals in the minimum increments as set forth in proposed Section 5.[41] Proposed Section 5(a) will provide that the Exchange would determine the minimum increment for bids and offers on FLEX Options on a class-by-class basis, which may not be smaller than $0.01.[42]

G. Types of Orders; Order and Quote Protocols (Section 6)

Pursuant to proposed Section 6(a), the Exchange may determine to make the order types and times-in-force, respectively, in Options 3, Section 7 available on a class or System basis for FLEX Orders.[43] The Exchange notes that it currently has the authority to make certain order types and times-in-force available on a class or System basis for non-FLEX Options pursuant to Options 3, Section 7, and therefore proposes to have similar authority with respect to FLEX Options.

Proposed Section 6(b) will provide that the following order and quote protocols in Supplementary Material .03 to Options 3, Section 7 will be available for FLEX Orders, FLEX auction notifications, and FLEX auction responses:

- FIX:[44] FLEX Orders and FLEX auction responses
- OTTO:[45] FLEX Orders, FLEX auction notifications, and FLEX auction responses

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41 See Cboe Rule 5.3(e)(3) for similar provisions, except the Exchange is not proposing to allow prices to be expressed as a percentage value, or to provide for Micro FLEX Index Options.

42 See Cboe Rule 5.4(c)(4) for similar provisions, except the Exchange is not proposing to allow prices to be expressed as a percentage value.

43 See Options 3, Section 7 for descriptions of these order types and times-in-force.

44 "Financial Information eXchange" or "FIX" is an interface that allows Members and their Sponsored Customers to connect, send, and receive messages related to orders and auction orders to the Exchange. Features include the following: (1) execution messages; (2) order messages; (3) risk protection triggers and cancel notifications; and (4) post trade allocation messages.

- SQF:[46] FLEX auction notifications and FLEX auction responses

H. Complex Orders (Section 7)

Pursuant to proposed Section 7(a), the Exchange may make complex orders, including a Complex Options Order,[47] Stock-Options Order,[48] and Stock-Complex Order[49] available for FLEX trading. Complex FLEX Orders may have up to the maximum number of legs determined by the Exchange.[50] Each leg of a complex FLEX Order: (1) must be for a FLEX Option series

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45 "Ouch to Trade Options" or "OTTO" is an interface that allows Members and their Sponsored Customers to connect, send, and receive messages related to orders, auction orders, and auction responses to the Exchange. Features include the following: (1) options symbol directory messages (e.g., underlying and complex instruments); (2) System event messages (e.g., start of trading hours messages and start of opening); (3) trading action messages (e.g., halts and resumes); (4) execution messages; (5) order messages; (6) risk protection triggers and cancel notifications; (7) auction notifications; (8) auction responses; and (9) post trade allocation messages..

46 "Specialized Quote Feed" or "SQF" is an interface that allows Market Makers to connect, send, and receive messages related to quotes, Immediate-or-Cancel Orders, and auction responses to the Exchange. Features include the following: (1) options symbol directory messages (e.g., underlying and complex instruments); (2) System event messages (e.g., start of trading hours messages and start of opening); (3) trading action messages (e.g., halts and resumes); (4) execution messages; (5) quote messages; (6) Immediate-or-Cancel Order messages; (7) risk protection triggers and purge notifications; (8) opening imbalance messages; (9) auction notifications; and (10) auction responses. The SQF Purge Interface only receives and notifies of purge requests from the Market Maker. Market Makers may only enter interest into SQF in their assigned options series.

47 A Complex Options Order is an order for a Complex Options Strategy, which is 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 Options 3, Section 14(a)(1).

48 A Stock-Option Order is an order for a Stock-Option Strategy, which is the purchase or sale of a stated number of units of an underlying stock or a security convertible into the underlying stock ("convertible security") coupled with the purchase or sale of options contract(s) on the opposite side of the market representing either (A) the same number of units of the underlying stock or convertible security, or (B) the number of units of the underlying stock necessary to create a delta neutral position, but in no case in a ratio greater than eight-to-one (8.00), where the ratio represents the total number of units of the underlying stock or convertible security in the option leg to the total number of units of the underlying stock or convertible security in the stock leg. See Options 3, Section 14(a)(2).

49 A Stock-Complex Order is an order for a Stock-Complex Strategy, which is the purchase or sale of a stated number of units of an underlying stock or a security convertible into the underlying stock ("convertible security") coupled with the purchase or sale of a Complex Options Strategy on the opposite side of the market representing either (A) the same number of units of the underlying stock or convertible security, or (B) the number of units of the underlying stock necessary to create a delta neutral position, but in no case in a ratio greater than eight-to-one (8.00), where the ratio represents the total number of units of the underlying stock or convertible security in the option legs to the total number of units of the underlying stock or convertible security in the stock leg. See Options 3, Section 14(a)(3).

50 The Exchange will initially permit a maximum of 10 legs.

authorized for FLEX trading with the same underlying equity security or index; (2) must have the same exercise style (American or European); and (3) for a FLEX Index Option, may have a different settlement type (a.m.-settled or p.m.-settled).[51]

Pursuant to proposed Section 7(b), complex FLEX Orders may not have to adhere to the ratio requirements in Options 3, Sections 14(a)(1) – (3), as determined by the Exchange on a class-by-class basis. Options 3, Sections 14(a)(1) – (3) currently includes the complex ratio requirements for Complex Options Strategies, Stock-Options Strategies, and Stock-Complex Strategies.[52] The Exchange is not changing the complex ratio requirements for non-FLEX complex orders under this proposal. Instead, it is proposing to offer this feature only for complex FLEX Orders so that Members may submit complex FLEX Orders with any ratio.[53] The Exchange notes that Cboe currently permits complex FLEX Orders to be submitted with any ratio.[54]

I. Opening of FLEX Trading (Section 8)

Proposed Section 8 will specify that there will be no Opening Process pursuant to Options 3, Section 8 in FLEX Options. Instead, Members may begin submitting FLEX Orders into an electronic FLEX Auction pursuant to proposed Section 11(b), a FLEX PIM pursuant to proposed Section 12, or a FLEX SOM pursuant to proposed Section 13 when the underlying

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51 See Cboe Rule 5.70(b) for similar provisions except the Exchange is not proposing Asian-settled or Cliquet-settled FLEX Index Options, as currently specified in Cboe Rule 5.70(b)(3).

52 See supra notes 47-49.

53 For instance, the Exchange may permit Complex Options Strategies with a ratio on the options legs less than one-to-three (.333) or greater than three-to-one (3.00), and Stock-Option Strategies with a ratio greater than eight-to-one (8.00), where the ratio represents the total number of units of the underlying stock or convertible security in the option leg(s) to the total number of units of the underlying stock or convertible security in the stock leg.

54 See Cboe US Options Complex Book Process, Section 2.1 (Ratios) and Section 3 (Complex FLEX Order Functionality), available at https://cdn.cboe.com/resources/membership/US-Options-Complex-Book-Process.pdf. Unlike Cboe, the Exchange will continue to require non-FLEX complex orders to adhere to the complex ratios in Options 3, Sections 14(a)(1) – (3), and therefore will not permit non-FLEX complex orders to be submitted in any ratio outside of those stipulated in Section 14.

security is open for trading.[55] Because market participants incorporate transaction prices of underlying securities or the values of underlying indexes when pricing options (including FLEX Options), the Exchange believes that it will benefit investors for FLEX Options trading to not be available until that information has begun to be disseminated in the market (i.e., when the security opens for trading).

Additionally, the Exchange's Opening Process is used to open or reopen a series of options on ISE at a single opening price.[56] There is a period of time before an options series opens during which orders placed on the Exchange's order book do not generate trade executions but may participate in the Opening Process.[57] As noted above, FLEX Options will not be placed on the Exchange's simple and complex order books and therefore will not have an Opening Process.[58] FLEX Options are created with terms unique to individual investment objectives. As such, each investor may require FLEX Options with slightly different terms than those already created. These individually defined FLEX Options are customized for each investor, so the Opening Process may not be useful for investors who may create their own FLEX Options because the Opening Process is designed, in part, to determine a single opening, or reopening, price based on orders and quotes from multiple Members. With the bespoke nature of FLEX Options, there is not the opportunity, nor the need, to bring together multiple orders and quotes as part of an Opening Process.

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[55] See proposed Options 3A, Section 8(a) and (b), which is based on Cboe Rule 5.71 except with respect to open outcry trading and trading sessions outside of regular trading hours.

[56] See Options 3, Section 8(h) and (j).

[57] See Options 3, Section 8(c).

[58] See proposed Options 3A, Section 10(a). Instead, Members will be required to submit FLEX Orders into an electronic FLEX Auction, FLEX PIM, or FLEX SOM. See proposed Options 3A, Section 11(a).

J. Trading Halts (Section 9)

Proposed Section 9 will provide that the Exchange may halt trading in a FLEX Option class pursuant to Options 3, Section 9, and always halts trading in a FLEX Option class when trading in a non-FLEX Options class with the same underlying equity security or index is halted on the Exchange. The System will not accept a FLEX Order for a FLEX Option series while trading in a FLEX Option class is halted.[59]

K. Exchange Order Books (Section 10)

Proposed Section 10 will provide that the Exchange's simple and complex order books will not be available for transactions in FLEX Options. Accordingly, FLEX Options may only be traded on the Exchange by submitting FLEX Orders into a FLEX Electronic Auction pursuant to proposed Options 11(b), FLEX PIM pursuant to proposed Options 12, and FLEX SOM pursuant to proposed Options 13, each as discussed further below. The Exchange notes that its proposal is in line with other options exchanges' FLEX rules that do not contemplate the interaction of their respective order books with FLEX transactions.[60]

L. FLEX Options Trading (Section 11)

Proposed Section 11 will describe the procedures for FLEX trading on the Exchange. Specifically, a FLEX Option series will only be eligible for trading if a Member submits a FLEX Order for that series into an electronic FLEX Auction pursuant to proposed paragraph (b) of Options 11, or submits the FLEX Order to a FLEX PIM or FLEX SOM Auction pursuant to proposed Section 12 or Section 13, respectively.[61]

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59 See Cboe Rule 4.21(a)(3) for materially identical provisions.

60 See e.g., NYSE Arca Rule 5.30-O(c). See also Securities Exchange Act Release No. 87235 (October 4, 2019), 84 FR 54671 (October 10, 2019) (SR-CBOE-2019-084) (among other changes, eliminating the availability of an electronic book for FLEX Options).

61 See proposed Options 3A, Section 11(a), which is based on Cboe Rule 5.72(b) except the Exchange is not proposing an open outcry FLEX Auction.

Proposed Section 11(a)(1) and (2) will specify the requirements for both simple and complex FLEX Orders.

- For a simple FLEX Order, a FLEX Order for a FLEX Option series submitted to the System must include all terms for a FLEX Option series set forth in proposed Section 3 as described above, size, side of the market, and a bid or offer price.[62] The Exchange also proposes that the System will not accept a FLEX Order with identical terms as a non-FLEX Option series that is already listed for trading to signify that this requirement is System-enforced.
- For a complex FLEX Order, a FLEX Order for a FLEX Option complex strategy submitted to the System must satisfy the criteria for a complex FLEX Order set forth in proposed Section 7(a) as described above, and include size, side of the market, and a net debit or credit price. Additionally, each leg of the FLEX Option complex strategy must include all terms for a FLEX Option series set forth in proposed Section 3.[63] Similar to simple FLEX Orders, the Exchange proposes to System enforce the stipulation that it will not accept a FLEX Option complex strategy if a leg in the order has identical terms as a non-FLEX Option series that is already listed for trading. Additionally, a complex FLEX Order submitted into the System for an electronic FLEX Auction pursuant to proposed Section 11(b), a FLEX PIM pursuant to Section 12, or a FLEX SOM pursuant to Section 13 must

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62 See Cboe Rule 5.72(b)(1) for similar provisions. The Exchange does not have an analogous rule as Cboe Rule 5.7, which specifies the different trading sessions during which the system is available to receive FLEX orders, and thus has not incorporated the applicable language. As noted above, the Exchange will accept FLEX Orders entered into an electronic FLEX Auction, FLEX PIM or FLEX SOM when the underlying security is open for trading. See proposed Options 3A, Section 8.

63 See Cboe Rule 5.72(b)(2) for similar provisions. As noted above for simple FLEX Orders, the Exchange does not have an analogous rule as Cboe Rule 5.7, and thus has not incorporated the applicable language. See supra note 62.

include a bid or offer price for each leg, which leg prices must add together to equal the net price.[64]

Proposed Section 11(b) will describe the electronic FLEX Auction. The proposed FLEX Auction will be substantially similar to Cboe's electronic FLEX Auction set forth in Cboe Rule 5.72(c), except for certain intended differences as further described below.[65] Specifically, a Member may electronically submit a FLEX Order (simple or complex) into an electronic FLEX Auction for execution pursuant to this paragraph (b). Pursuant to proposed subparagraph (b)(1), a FLEX Auction may be initiated if all of the below conditions in proposed subparagraph (b)(1)(A) – (G) are met; otherwise, the System rejects or cancels a FLEX Order that does not meet the conditions in this subparagraph (b)(1).[66]

- **Class**: The FLEX Order is in a class of options the Exchange is authorized to list for trading on the Exchange.
- **Size**: There is no minimum size for FLEX Orders.
- **Terms**: A simple or complex FLEX Order must comply with proposed Section 11(a).
- **Price**: The bid or offer price, or the net debit or credit price, as applicable, of the FLEX Order is the "auction price."
- **Time**: A FLEX Order may only be submitted for electronic execution in a FLEX Auction after FLEX trading has opened pursuant to proposed Section 8.

64 See proposed Options 3A, Section 11(a)(2)(A), which is based on Cboe Rule 5.72(b)(2)(A) except the Exchange will also add references to FLEX PIM and FLEX SOM for accuracy and completeness.

65 See also Securities Exchange Act Release No. 87235 (October 4, 2019), 84 FR 54671 (SR-CBOE-2019-084) (October 10, 2019) (adopting an electronic FLEX Auction on Cboe, among other changes).

66 Proposed paragraph (b) is based on Cboe Rule 5.72(c). The proposed eligibility requirements for the FLEX Auction in subparagraph (b)(1) are similar to Cboe Rule 5.72(c)(1), except as noted below.

- **Exposure Interval**: The submitting Member must designate the length of the "exposure interval," which must be between three seconds and five minutes.[67] If the designated time exceeds the market close, then the FLEX Auction will end at the market close with an execution, if an execution is permitted pursuant to proposed Section 11(b).[68]
- **Minimum Increment**: The price of a simple FLEX Order must be in an increment the Exchange determines on a class basis (which may not be smaller than the amounts set forth in proposed Section 5 (i.e., $0.01)). If the FLEX Order is a complex order, the price must be a net price for the complex strategy.[69] The foregoing rule proposal will be substantially similar to the minimum increment requirements in Cboe Rules 5.73(a)(5) and 5.74(a)(5). While the Exchange will align to Cboe's minimum increment requirements (i.e., $0.01) for the individual options legs of a complex FLEX Order entered into a FLEX Auction, the Exchange also proposes to align the minimum increment requirements for stock-tied FLEX complex strategies with the existing requirements for stock-tied non-

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67 There will be no default setting to the FLEX Auction exposure interval. As such, Members will be required to specify the exposure interval; otherwise, their FLEX Order will be rejected by the System.

68 Cboe Rule 5.72(c)(1)(F) does not specify whether an execution would occur (if permitted) when the designated time exceeds the market close, and only expressly prohibits the designated time from going beyond the market close. While the Exchange's rules are silent in this regard, the Exchange notes that its proposal will follow current non-FLEX auction behavior, including current PIM and SOM behavior. In doing so, the Exchange's proposal will promote executions in electronic FLEX Auctions and also prevent executions after the market close.

69 See proposed subparagraph (G) of Section 11(b)(1). While Cboe's electronic FLEX Auction eligibility requirements in Rule 5.72(c)(1) are silent on minimum increments, the eligibility requirements for Cboe's FLEX AIM and FLEX SAM in Cboe Rules 5.73(a)(5) and 5.74(a)(5), respectively, address minimum increments. The Exchange believes it will be helpful to add a similar requirement for electronic FLEX Auctions for greater consistency and clarity. The Exchange also notes that unlike Cboe, it is not proposing to allow exercise prices to be expressed as percentages, and will therefore not incorporate the applicable provisions. As discussed above, the Exchange is also incorporating within proposed subparagraph (G) the minimum increment provisions for non-FLEX complex orders that are stock-tied from Options 3, Section 14(c)(1).

FLEX complex strategies as set forth in Options 3, Section 14(c)(1). As such, proposed Options 3A, Section 11(b)(1)(G) will further provide that the prices of Complex Options Strategies (as defined in Options 3, Section 14) may be expressed in one cent ($0.01) increments, and the options leg of Complex Options Strategies may be executed in one cent ($0.01) increments, regardless of the minimum increments otherwise applicable to the individual options legs of the order. Prices of Stock-Option Strategies or Stock-Complex Strategies (each as defined in Options 3, Section 14) may be expressed in any decimal price determined by the Exchange,[70] and the stock leg of a Stock-Option Strategy or Stock-Complex Strategy may be executed in any decimal price permitted in the equity market. The options leg of a Stock-Option Strategy or Stock-Complex Strategy may be executed in one cent ($0.01) increments, regardless of the minimum increments otherwise applicable to the individual options legs of the order. Similar to stock-tied complex orders today, the Exchange believes that smaller minimum increments are appropriate for complex FLEX Orders that contain a stock component as the stock component can trade at finer decimal increments permitted by the equity market.

Proposed subparagraph (b)(2) of Options 11 will describe the FLEX Auction process, and will provide that upon receipt of a FLEX Order that meets the conditions in subparagraph (a) as described above, the FLEX Auction commences. Proposed subparagraph (b)(2)(A) will describe the contents of the FLEX Auction message, and will provide that the System initiates a FLEX Auction by sending a FLEX Auction notification message to Members detailing the FLEX

70 The minimum increment for Stock-Option Strategies and Stock-Complex Strategies can currently be expressed to four decimal places.

Option series or complex strategy (as applicable), side, size, auction ID,[71] capacity, and exposure interval. FLEX Auction notification messages are not disseminated to OPRA.[72] Like Cboe, the FLEX Auction message will not include the price of the auctioned FLEX Order. The Exchange believes not including the auction price in the notification message will encourage Members to respond with the best prices at which they are willing to trade against the auctioned FLEX Order. If the message included the price, Members may only respond to trade at that price; without the price, Members may respond at better prices, which may result in price improvement opportunities for the auctioned FLEX Order.

Proposed subparagraph (b)(2)(B) will provide that one or more FLEX Auctions in the same FLEX Option series or complex strategy (as applicable) may occur at the same time. To the extent there is more than one FLEX Auction in a FLEX Option series or complex strategy (as applicable) underway at the same time, the FLEX Auctions conclude sequentially based on the times at which each FLEX Auction's exposure interval concludes. At the time each FLEX Auction concludes, the System allocates the FLEX Order pursuant to proposed subparagraph (3) and takes into account all FLEX responses submitted during the exposure interval.[73] Generally, if a Member attempts to initiate an electronic FLEX Auction in a FLEX Option series while another auction in that series is ongoing, the Exchange believes it will provide that second FLEX Order with an opportunity for execution in a timely manner by initiating another FLEX Auction, rather than having the Member wait for the first auction to conclude. The second Member may

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71 As discussed below, this information on the proposed auction message will permit responses to only execute at the conclusion of the auction into which the responses were submitted.

72 See Cboe Rule 5.72(c)(2)(A) for similar provisions, except with respect to the exposure interval and Attributable designation. The Exchange will simply disseminate the duration of the exposure interval, instead of calculating and disseminating what time the auction will conclude like Cboe. In addition, the Exchange is not proposing to offer an Attributable designation for FLEX Orders like Cboe does today.

73 See Cboe Rule 5.72(c)(2)(B) for materially identical provisions.

not be able to submit a response to trade in the ongoing FLEX Auction, because the terms may not be consistent with that Member's order (for example, there may not be sufficient size, and the Member may only receive a share of the auctioned order depending on other responses). Therefore, the Exchange believes providing this proposed functionality may encourage Members to use electronic FLEX Auctions to execute their FLEX Orders.

Proposed subparagraph (b)(2)(C) will provide that the submitting Member may cancel a FLEX Auction prior to the end of the exposure interval.[74] Proposed subparagraph (b)(2)(D) will specify the conditions for submitting responses to a FLEX Auction. Any Member (including the submitting Member) may submit responses to a FLEX Auction that are properly marked specifying the FLEX Option series or complex strategy (as applicable), bid or offer price or net price (respectively), size, side of the market, and the auction ID for the FLEX Auction to which the Member is submitting the response. A FLEX response may only participate in the FLEX Auction with the auction ID specified in the response, which is why the auction notification message described above will include an auction ID and responses must identify the applicable auction ID.[75] If there are concurrent FLEX Auctions occurring, a Member may submit responses to all ongoing auctions, and thus concurrent auctions will not hinder a Member's ability to participate in any FLEX Auction.

A Member using the same badge/[76]mnemonic[77] may only submit a single FLEX response per auction ID to a FLEX Auction. If an additional FLEX response is submitted for the same

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[74] See Cboe Rule 5.72(c)(2)(C) for materially identical provisions.

[75] See Cboe Rule 5.72(c)(2)(D) for materially identical provisions.

[76] A "badge" shall mean an account number, which may contain letters and/or numbers, assigned to Market Makers. A Market Maker account may be associated with multiple badges. See Options 1, Section 1(a)(5).

[77] A "mnemonic" shall mean an acronym comprised of letters and/or numbers assigned to Electronic Access Members. An Electronic Access Member account may be associated with multiple mnemonics. See Options 1, Section 1(a)(23).

auction ID from the same badge/mnemonic, then that FLEX response will automatically replace the previous FLEX response.[78] The System caps the size of a FLEX response for the same badge/mnemonic at the size of the FLEX Order (i.e., the System ignores the size in excess of the size of the FLEX Order when processing the FLEX Auction).[79] Given that the Exchange is proposing below to apply a pro-rata allocation methodology to executions at the conclusion of the FLEX Auction, this provision is intended to prevent a Member from submitting a response with an extremely large size into the electronic FLEX Auction in order to obtain a larger pro-rata share of the FLEX Order.

Further, FLEX responses must be on the opposite side of the market as the FLEX Order. The System rejects a FLEX response on the same side of the market as the FLEX Order.[80] FLEX responses are not visible to Members or disseminated to OPRA.[81] This is consistent with how Cboe treats FLEX responses pursuant to Cboe Rule 5.72(c)(2)(D)(iv). The proposed rule change is also consistent with the Exchange's existing auctions, in which responses are not visible to the market.[82] Responses to electronic auctions are not firm prior to the conclusion of the auction, at which time their price and size are firm. For the same reason as the Exchange is proposing not to disseminate the auction price on the auction notification message as discussed

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78 See proposed Options 3A, Section 11(b)(2)(D)(i), which is based on Cboe Rule 5.72(c)(2)(D)(i) except the Exchange will not allow Members to submit multiple FLEX responses using the same badge/mnemonic, and will not aggregate all of the Member's FLEX responses. While not specified in the Exchange's current rules, this is consistent with current auction behavior, including current PIM and SOM behavior.

79 See proposed Options 3A, Section 11(b)(2)(D)(ii), which is based on Cboe Rule 5.72(c)(2)(D)(ii) except the Exchange will not aggregate all of the Member's FLEX responses. See supra note 78.

80 See proposed Options 3A, Section 11(b)(2)(D)(iii), which is based on Cboe Rule 5.72(c)(2)(D)(iii).

81 See proposed Options 3A, Section 11(b)(2)(D)(iv), which is based on Cboe Rule 5.72(c)(2)(D)(iv).

82 See Supplementary Material .02 to Options 3, Section 11; and Options 3, Section 13(c)(4).

above, the Exchange believes it will encourage Members to submit responses at their best possible price if they do not know the prices at which other Members are willing to trade.[83]

A Member may modify or cancel it FLEX Responses during the exposure interval.[84] The minimum price increment for FLEX responses is the same as the one the Exchange determines for a class pursuant to proposed subparagraph (b)(1)(G) above. A response to a FLEX Auction of a complex order must have a net price. The System rejects a FLEX response that is not in the applicable minimum increment.[85]

Pursuant to proposed subparagraph (b)(3) of Section 11, the FLEX Auction concludes at the end of the exposure interval, unless the Exchange halts trading in the affected series or the submitting Member cancels the FLEX Auction, in which case the FLEX Auction concludes without execution.[86] At the conclusion of the FLEX Auction:

- Pursuant to proposed subparagraph (b)(3)(A), the System executes the FLEX Order against the FLEX responses at the best price(s), to the price at which the balance of the FLEX Order or the FLEX responses can be fully executed (the "final auction price"). For purposes of ranking FLEX responses when

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83 For example, if during a FLEX Auction of a buy FLEX Order, a Member submitted a response to sell at \$1.05, if another Member saw that response, it may merely respond to sell at \$1.05, or maybe \$1.04, even though it may ultimately be willing to sell at \$1.03. Without seeing the other responses, the second Member may instead submit a response to sell at \$1.03, which could result in price improvement for the auctioned order.

84 See proposed Options 3A, Section 11(b)(2)(D)(v), which is based on Cboe Rule 5.72(c)(2)(D)(v).

85 See proposed Options 3A, Section 11(b)(2)(D)(vi). While Cboe's electronic FLEX Auction response requirements in Rule 5.72(c)(2)(D) are silent on minimum increments, the response requirements for Cboe's FLEX AIM and FLEX SAM in Cboe Rules 5.73(c)(5)(A) and 5.74(c)(5)(A), respectively, have similar provisions. The Exchange believes it will be helpful to add a similar requirement for electronic FLEX Auction responses for greater consistency and clarity. The Exchange also notes that unlike Cboe, it is not proposing to allow percentage formats for exercise prices of FLEX Options, and will therefore not incorporate the applicable provisions.

86 See Cboe Rule 5.72(c)(3) for materially identical provisions.

determining how to allocate a FLEX Order, the term “price” refers to the dollar and decimal amount of the response bid or offer.[87]

- Pursuant to proposed subparagraph (b)(3)(A)(i), if there are multiple FLEX responses at the same price level, then the contracts in those FLEX responses are allocated proportionally according to Size Pro-Rata Priority[88] with Priority Customer overlay[89] (as described in Options 3, Section 10(c)). The Exchange notes that this is similar to Cboe Rule 5.72(c)(3)(A)(i), except Cboe applies no overlays to its size pro-rata allocation methodology whereas the Exchange will apply an overlay for Priority Customers on top of its standard size pro-rata allocation methodology. This is consistent with the Exchange’s standard allocation methodology in its auctions for non-FLEX Options.[90]
- Pursuant to proposed subparagraph (b)(3)(A)(ii), the executable quantity is allocated to the nearest whole number, with fractions rounded up for the FLEX response with the higher quantity. Further, proposed subparagraph (b)(3)(A)(iii) will provide that if an allocation would result in less than one contract, then one contract will be allocated. The Exchange is not adopting the rounding and allocation language in Cboe Rule 5.72(c)(3)(A)(ii) and (iii), but is rather adopting

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87 See Cboe Rule 5.72(c)(3)(A) for similar provisions, except the Exchange is not proposing to allow percentage values of the response bid or offer.

88 Size Pro-Rata Priority shall mean that if there are two or more resting orders or quotes at the same price, the System allocates contracts from an incoming order or quote to resting orders and quotes beginning with the resting order or quote displaying the largest size proportionally according to displayed size, based on the total number of contracts displayed at that price. See Options 3, Section 10(c).

89 Priority Customer overlay mean that the highest bid and lowest offer shall have priority except that Priority Customer orders shall have priority over non- Priority Customer interest at the same price in the same options series. If there are two or more Priority Customer orders for the same options series at the same price, priority shall be afforded to such Priority Customer orders in the sequence in which they are received by the System. See Options 10, Section 10(c)(1)(A).

90 See, e.g., Options 3, Section 11(d)(3)(C) (SOM allocation methodology) and Options 3, Section 13(d) (PIM allocation methodology).

language that is consistent with its current rounding and allocation methodology as the Exchange does not allocate fractional contracts and instead rounds up to the nearest whole number.[91]

Pursuant to proposed subparagraph (b)(3)(B), the System cancels an unexecuted FLEX Order (or unexecuted portion).[92] Further, proposed subparagraph (b)(3)(C) will provide that the System cancels any unexecuted responses (or unexecuted portions).[93]

M. FLEX PIM (Section 12)

The Exchange proposes to establish PIM auction functionality for FLEX Options in Options 3A, Section 12. The proposed FLEX PIM auction will be substantially similar to Cboe's FLEX AIM in Cboe Rule 5.73, except for certain intended differences as further described below. Pursuant to proposed Section 12, a Member (the "Initiating Member") may electronically submit for execution an order (which may be a simple or complex order) it represents as agent ("Agency Order") against principal interest or a solicited order(s) (except, if the Agency Order is a simple order, for an order for the account of any FLEX Market Maker with an appointment in the applicable FLEX Option class on the Exchange) (an "Initiating Order"), provided it submits the Agency Order for electronic execution into a FLEX PIM auction pursuant to this Rule.[94]

Proposed Section 12(a)(1) – (5) will set forth the FLEX PIM auction eligibility requirements. Specifically, the Initiating Member may initiate a FLEX PIM auction if all of the following conditions are met:

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91 See Options 3, Section 10(c), Supplementary Material .09 to Options 3, Section 11, and Supplementary Material .10 to Options 3, Section 13.

92 See Cboe Rule 5.72(c)(3)(B) for materially identical provisions.

93 See Cboe Rule 5.72(c)(3)(C) for materially identical provisions.

94 See Cboe Rule 5.73 for similar provisions, except the Exchange will not incorporate the reference to FLEX SPX as this is a Cboe-specific product.

- **Class**. An Agency Order must in a FLEX Option class the Exchange designates as eligible for FLEX PIM auctions.
- **FLEX Option Series.** The Agency Order and Initiating Order must each be a FLEX Order that complies with proposed Section 11(a) in a permissible FLEX Option series that complies with proposed Section 3(b).
- **Marking.** The Initiating Member must mark an Agency Order for FLEX PIM auction processing.
- **Size.** There will be no minimum size for Agency Orders. The Initiating Order must be for the same size as the Agency Order.
- **Minimum Increment.** The price of the Agency Order and Initiating Order for simple FLEX Orders must be in an increment the Exchange determines on a class basis (which may not be smaller than the amounts set forth in Section 5 above). If the Agency Order and Initiating Order are complex orders, the price must be a net price for the complex strategy.[95] While the Exchange will align to Cboe's minimum increment requirements (i.e., $0.01) for the individual options legs of a complex FLEX Order entered into a FLEX PIM, the Exchange also proposes to align the minimum increment requirements for stock-tied FLEX complex strategies with the existing requirements for stock-tied non-FLEX complex strategies as set forth in Options 3, Section 14(c)(1). As such, proposed Options 3A, Section 12(a)(5) will further provide that the prices of Complex Options Strategies (as defined in Options 3, Section 14) may be expressed in one cent

[95] The Exchange notes that unlike Cboe, it will not allow prices to be entered as a percentage value, and therefore will not incorporate the applicable language from Cboe Rule 5.73(a)(5) into proposed Section 12(a)(5). As discussed above, the Exchange will also add existing complex order minimum increment requirements in Options 3, Section 14(c)(1) to align the proposed FLEX functionality with non-FLEX functionality.

($0.01) increments, and the options leg of Complex Options Strategies may be executed in one cent ($0.01) increments, regardless of the minimum increments otherwise applicable to the individual options legs of the order. Prices of Stock-Option Strategies or Stock-Complex Strategies (each as defined in Options 3, Section 14) may be expressed in any decimal price determined by the Exchange,[96] and the stock leg of a Stock-Option Strategy or Stock-Complex Strategy may be executed in any decimal price permitted in the equity market. The options leg of a Stock-Option Strategy or Stock-Complex Strategy may be executed in one cent ($0.01) increments, regardless of the minimum increments otherwise applicable to the individual options legs of the order. Similar to stock-tied complex orders today, the Exchange believes that smaller minimum increments are appropriate for complex FLEX Orders that contain a stock component as the stock component can trade at finer decimal increments permitted by the equity market.

- **Time**. An Initiating Member may only submit an Agency Order to a FLEX PIM auction after trading in FLEX Options is open pursuant to proposed Section 8.

The System will reject or cancel both an Agency Order and Initiating Order submitted to a FLEX PIM auction that do not meet the conditions in proposed paragraph (a) as described above. The proposed FLEX PIM eligibility requirements in proposed Section 12(a) are substantially similar to Cboe's FLEX AIM eligibility requirements in Cboe Rule 5.73(a), except with respect to the language related to the percentage value, as noted above.

Pursuant to proposed Section 12(b), the Initiating Order must stop the entire Agency Order at a specified price. If the Agency Order and Initiating Order are Complex Orders, the

96 The minimum increment for Stock-Option Strategies and Stock-Complex Strategies can currently be expressed to four decimal places.

price must be a net price for the complex strategy.[97] In particular, the Initiating Member must specify either of the below; otherwise, the System will reject or cancel both an Agency Order and Initiating Order submitted to a FLEX PIM auction that do not meet the conditions in this proposed paragraph (b).

- Pursuant to proposed subparagraph (b)(1), a single price at which it seeks to execute the Agency Order against the Initiating Order (a "single-price submission"), including whether it elects to have less than its guaranteed allocation (as described in proposed Section 12(e)(4) below). This is similar to Cboe Rule Rule 5.73(b)(1), except the Exchange is not proposing to allow Initiating Members to elect for the Initiating Order to have last priority to trade against the Agency Order, and will instead allow them to elect less than their guaranteed allocation. As further discussed below, the proposed guaranteed allocation option will be based on the guaranteed allocation option available in non-FLEX PIM auctions, and therefore the proposed rule change will provide further consistency across the Exchange's auction mechanisms.
- Pursuant to subparagraph (b)(2), an initial stop price and instruction to automatically match the price and size of all FLEX PIM responses ("auto-match") at each price, up to a designated limit price, better than the price at which the balance of the Agency Order can be fully executed (the "final auction price"). This is materially identical to Cboe Rule 5.73(b)(2).

97 See Cboe Rule 5.73(b) for similar provisions, except the Exchange will not allow prices to be entered as a percentage value, and therefore will not incorporate the applicable language from Cboe's rule into proposed Section 12(b).

Proposed Section 12(c) will govern the FLEX PIM auction process. Specifically, upon receipt of an Agency Order that meets the conditions in paragraphs (a) and (b) as described above, the FLEX PIM auction process commences. Proposed subparagraphs (c)(1)(A) and (B) will describe concurrent FLEX PIM auctions for simple Agency Orders and complex Agency Orders, respectively. One or more FLEX PIM auctions in the same FLEX Option series or same complex strategy (as applicable) may occur at the same time.[98] To the extent there is more than one FLEX PIM auction in a FLEX Option series or complex strategy (as applicable) underway at the same time, the FLEX PIM auctions will conclude sequentially based on the times at which the FLEX PIM auction periods end. At the time each FLEX PIM auction concludes, the System allocates the Agency Order pursuant to proposed paragraph (e) as described below, and takes into account all FLEX PIM responses received during the FLEX PIM auction period. The concurrent FLEX PIM auction feature in proposed Section 12(c)(1)(A) and (B) is materially identical to Cboe Rule 5.73(c)(1)(A) and (B), and is also consistent with the concurrent auction feature proposed above for FLEX Auctions. Similar to FLEX Auctions as proposed above, if a Member attempts to initiate a FLEX PIM Auction in a FLEX Option series while another auction in that series in ongoing, the Exchange believes it will provide that second FLEX Order with an opportunity for execution in a timely manner by initiating another FLEX PIM Auction, rather than requiring the Member to wait for the first auction to conclude. The second Member may not be able to submit a response to trade in the ongoing FLEX PIM Auction because the terms may not be consistent with that Member's order (for example, there may not be sufficient size, and the Member may only receive a share of the auctioned order depending on other responses).

[98] Further, for complex Agency Orders, PIM auctions in different complex strategies may be ongoing at any given time, even if the complex strategies have overlapping components. A FLEX PIM auction in a complex strategy may be ongoing at the same time as a FLEX PIM auction in any component of the complex strategy. See proposed subparagraph (c)(1)(B)(i) of Options 3A, Section 12.

Therefore, the Exchange believes that providing this functionality for FLEX PIM may provide additional opportunities for execution of FLEX Orders by encouraging Members to use FLEX PIM.

Pursuant to proposed Section 12(c)(2), the System initiates the FLEX PIM auction process by sending a FLEX PIM auction notification message detailing the side, size, auction ID, the length of the FLEX PIM auction period, and FLEX Option series or complex strategy, as applicable, of the Agency Order to all Members that elect to receive FLEX PIM auction notification messages. The Exchange may also determine to include the stop price in FLEX PIM auction notification messages, which will apply to all FLEX PIM auctions. FLEX PIM auction notification messages will not be disseminated to OPRA.[99]

Proposed Section 12(c)(3) will describe the "FLEX PIM Auction period," and is based on Cboe Rule 5.73(c)(3). The FLEX PIM Auction period will be defined as a period of time that must be designated by the Initiating Member, which may be no less than three seconds and no more than five minutes. Similar to the exposure interval for electronic FLEX Auctions in Section 11(b) discussed above, the Initiating Member will be required to identify a length of time within the specified parameters for FLEX PIM as there will be no default for the FLEX PIM Auction period. Otherwise, their FLEX Order will be rejected by the System. Further, if the designated length of the FLEX PIM Auction period exceeds the market close, then the auction will end at the market close with an execution, if an execution is permitted by this Section 12. Cboe's rule does not specify whether an execution (if permitted) would occur if the designated length exceeds the market close. However, the Exchange's non-FLEX auctions currently allow executions (as permitted by their respective rules) to occur in such scenarios, so the Exchange

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99 See Cboe Rule 5.73(c)(2) for substantially similar provisions except the Exchange will not incorporate the reference to SPX as it does not list this symbol.

proposes to be consistent with current System functionality in this regard.[100] In doing so, the Exchange's proposal will promote executions in FLEX PIM and also prevent executions after the market close.

Proposed Section 12(c)(4) will provide that an Initiating Member may not modify or cancel an Agency Order or Initiating Order after submission to a FLEX PIM auction, except to improve the price of the Initiating Order. This will be similar to Cboe Rule 5.73(c)(4) except unlike Cboe, the Exchange will allow a limited exception by allowing Initiating Members to improve the price of their Initiating Orders. The Exchange notes that this will align to current non-FLEX PIM behavior, which allows entering Members to modify their Counter-Side Orders[101] upon entry into the PIM by improving upon the initial price of the Counter-Side Order.[102]

Proposed Section 12(c)(5) will govern the requirements for FLEX PIM responses. Specifically:

- Any Member other than the Initiating Member (the System rejects a response with the same badge/mnemonic as the Initiating Order) may submit responses to a FLEX PIM auction that are properly marked specifying price, size, side, and the auction ID for the FLEX PIM auction to which the Member is submitting the

[100] While this behavior is not explicitly stated in the current Rules, the Exchange's proposal will be consistent with current non-FLEX auction behavior, including current PIM and SOM behavior.

[101] Counter-Side Orders for PIM are the equivalent to Initiating Orders for FLEX PIM. See Options 3, Section 13(b) for a description of Counter-Side Orders.

[102] See Options 3, Section 13(b)(5) as modified by SR-ISE-2023-06 (not yet implemented) (providing that the Crossing Transaction may not be canceled or modified, but the price of the Counter-Side Order may be improved during the exposure period).

response. A FLEX PIM response may only participate in the FLEX PIM auction with the auction ID specified in the response.[103]

- The minimum price increment for FLEX PIM responses is the same as the one the Exchange determines for a class pursuant to proposed Section 12(a)(5) above. A response to a FLEX PIM auction of a complex Agency Order must have a net price. The System will reject a FLEX PIM response that is not in the applicable minimum increment.[104]
- A Member using the same badge/mnemonic may only submit a single FLEX PIM response per auction ID for a given auction. If an additional FLEX PIM response is submitted for the same auction ID from the same badge/mnemonic, then that FLEX PIM response will automatically replace the previous FLEX PIM response.[105]
- The System will cap the size of a FLEX PIM response at the size of the Agency Order (i.e., the System will ignore size in excess of the size of the Agency Order when processing the FLEX PIM auction).[106]

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103 See proposed Options 3A, Section 12(c)(5), which is based on Cboe Rule 5.73(c)(5).

104 See proposed Options 3A, Section 12(c)(5)(A), which is based on Cboe Rule 5.73(c)(5)(A) except the Exchange will not allow prices to be expressed as a percentage value. Further, the Exchange will not incorporate the Cboe rule portions on Index Combo Orders as the Exchange does not offer this functionality.

105 See proposed Options 3A, Section 12(c)(5)(B), which will be different from Cboe Rule 5.73(c)(5)(B) because the Exchange will not allow Members to submit multiple FLEX PIM responses using the same badge/mnemonic, and will not aggregate all of the Member's FLEX PIM responses. While the rules are currently silent in this regard, this will align to current non-FLEX auction behavior, including PIM auction behavior.

106 See proposed Options 3A, Section 12(c)(5)(C), which is based on Cboe Rule 5.73(c)(5)(C) except the Exchange will not allow Members to submit multiple FLEX PIM responses using the same badge/mnemonic, and will not aggregate all of the Member's FLEX PIM responses. As noted above, this will align to current non-FLEX auction functionality, including PIM auction functionality in Options 3, Section 13.

- FLEX PIM responses must be on the opposite side of the market as the Agency Order. The System rejects a FLEX PIM response on the same side of the market as the Agency Order.[107]
- FLEX PIM responses will not be visible to PIM auction participants or disseminated to OPRA.[108]
- A Member may modify or cancel its FLEX PIM responses during the FLEX PIM auction.[109]

Pursuant to proposed Section 12(d), a FLEX PIM auction concludes at the earliest to occur of the following times: (1) the end of the FLEX PIM auction period; and (2) any time the Exchange halts trading in the affected series, provided, however, that in such instance the FLEX PIM auction concludes without execution.[110]

Proposed Section 12(e) will govern how executions will occur in FLEX PIM. In particular, at the end of the FLEX PIM auction, the System allocates the Initiating Order or FLEX PIM responses against the Agency Order at the best price(s), to the price at which the balance of the Agency Order can be fully executed (the "final auction price"), as follows. For purposes of ranking the Initiating Order and FLEX PIM responses when determining how to allocate the Agency Order against the Initiating Order and those responses, the term "price" refers to the dollar and decimal amount of the order or response bid or offer.[111] Proposed

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[107] See proposed Options 3A, Section 12(c)(5)(D), which is materially identical to Cboe Rule 5.73(c)(5)(D).

[108] See proposed Options 3A, Section 12(c)(5)(E), which is materially identical to Cboe Rule 5.73(c)(5)(E).

[109] See proposed Options 3A, Section 12(c)(5)(F), which is materially identical to Cboe Rule 5.73(c)(5)(F).

[110] See Cboe Rule 5.73(d) for materially identical provisions.

[111] See Cboe Rule 5.73(e) for similar provisions except the Exchange will not allow prices to be expressed as a percentage value.

subparagraphs (e)(1) – (4) details the FLEX PIM allocation methodology for the following scenarios:

- **No Price Improvement**: If the FLEX PIM auction results in no price improvement, the System executes the Agency Order at the stop price in the following order:
  - Priority Customer responses (in time priority);[112]
  - The Initiating Order for the greater of (1) one contract or (2) up to 50% of the Agency Order if there is a response(s) from one other Member at the same price or 40% of the Agency Order if there are responses from two or more other Members at the same price (which percentages are based on the original size of the Agency Order).[113] Unless there are remaining contracts after including all PIM responses, under no circumstances does the Initiating Member receive an allocation percentage at the final auction price of more than 50% of the initial Agency Order in the event there is a response(s) from one other Member or 40% of the initial Agency Order in the event there are responses from two or more other Members, except when rounding up. The Exchange is specifying two limited scenarios in this Rule where the Initiating Member may receive an allocation percentage greater than its guaranteed allocation percentage, which is either when there are remaining contracts after including all PIM

112 See proposed Section 12(e)(1)(A), which is materially identical to Cboe Rule 5.73(e)(1)(A).

113 See proposed Section 12(e)(1)(B)(ii), which is based on Cboe Rule 5.73(e)(1)(B)(ii) except the percentages will be based on the original size of the Agency Order, instead of the number of contracts remaining after execution against Priority Customer responses like Cboe. This will align to current PIM functionality. See Options 3, Section 13(d)(3). See infra note 121 for further discussion on allocation percentages.

responses or when rounding up.[114] As an example of the first scenario, assume an Initiating Member submitted a FLEX Order for 20 contracts into FLEX PIM and there are 2 PIM responses (one for 3 contracts and one for 4 contracts). After the 7 PIM responses are allocated, the Initiating Member would then receive the remaining 13 contracts (which is more than their 40% allocation percentage) because there are remaining contracts after all PIM responses are included.

  - All other FLEX PIM responses, allocated on a Size Pro-Rata basis (as defined in Options 3, Section 10(c));[115] and
  - The Initiating Order to the extent there are any remaining contracts.[116]

- **Price Improvement with Single-Price Submission**: If the FLEX PIM auction results in price improvement for the Agency Order and the Initiating Member selected a single-price submission, at each price better than the final auction price, the System executes the Agency Order in the following order:
  - Priority Customer responses (in time priority);[117]
  - Other FLEX PIM responses (in time priority) at prices better than the final auction price; and

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114 See proposed Section 12(e)(1)(B), which is based on Cboe Rule 5.73(e)(1)(B) except with respect to the two limited scenarios discussed above. This behavior will align to current PIM functionality. While the Exchange's rules are silent on the first scenario, the rounding up scenario is specified in Options 3, Section 13(d)(7).

115 See proposed Section 12(e)(1)(C), which is materially identical to Cboe Rule 5.73(e)(1)(C). The Exchange notes that Size Pro-Rata (as defined in Options 3, Section 10(c)) is similar to pro-rata as referenced in the Cboe rule (and as defined in Cboe Rule 5.32(a)(1)(B)).

116 See proposed Section 12(e)(1)(D), which is materially identical to Cboe Rule 5.73(e)(1)(D).

117 See proposed Section 12(e)(2)(A), which is materially identical to Cboe Rule 5.73(e)(2)(A).

- All other FLEX PIM responses at the final auction price, allocated on a Size Pro-Rata basis (as defined in Options 3, Section 10(c)).[118]

For example, assume a FLEX PIM Agency Order is sent for 100 contracts with a price of $1.00 and the Initiating Member selected a single-price submission. There are two PIM responses for 5 contracts each at $0.98, two PIM responses for 20 contracts each at $0.99, and two PIM responses for 40 contracts each at $1.00. The PIM responses at $0.98 and $0.99 will be executed in their entirety. The PIM responses at $1.00 (final auction price) will be executed on a Size Pro-Rata basis. At the final auction price, the System executes any remaining contracts from the Agency Order at that price in the order set forth in proposed subparagraph (e)(1), as described above.[119]

- **Price Improvement with Auto-Match**: If the FLEX PIM auction results in price improvement for the Agency Order and the Initiating Member selected auto-match, at each price better than the final auction price up to the designated limit price, the System executes the Agency Order against the Initiating Order for the number of contracts equal to the aggregate size of all FLEX PIM responses and then executes the Agency Order against those responses in the order set forth in proposed subparagraph (e)(2) described above. At the final auction price, the

118 See proposed Section 12(e)(2)(B), which is based on Cboe Rule 5.73(e)(2)(B), except the Exchange will specify that other FLEX PIM responses at prices better than the final auction price will be allocated in time priority and all other FLEX PIM responses at the final auction price will be allocated on a Size Pro-Rata Basis. While the current rules are silent in this regard, this behavior follows current PIM behavior.

119 See proposed Section 12(e)(2), which is materially identical to Cboe Rule 5.73(e)(2).

System executes contracts at that price in the order set forth in proposed subparagraph (e)(1) described above.[120]

- **Guaranteed Allocation**: If the Initiating Member selects a single-price submission, it may elect for the Initiating Order to have less than their guaranteed allocation (50% if there is a response(s) from one other Member or 40% if there are responses from two or more Members) to trade against the Agency Order. The Initiating Member may select a lesser percentage than their guaranteed allocation. If the Initiating Member elects 0%, then notwithstanding subparagraphs (e)(1) and (2), the System only executes the Initiating Order against any remaining Agency Order contracts at the stop price after the Agency Order is allocated to all FLEX PIM responses at all prices equal to or better than the stop price. Guaranteed allocation information is not available to other market participants and may not be modified after it is submitted.[121]

Pursuant to proposed Section 12(e)(5), the System cancels any unexecuted FLEX PIM responses (or unexecuted portions) at the conclusion of the FLEX PIM auction.[122]

Lastly, the Exchange proposes a number of policies applicable to FLEX PIM as Supplementary Materials to Options 3A, Section 12. Specifically, proposed Supplementary Material .01 will provide that a Member may only use a FLEX PIM auction where there is a

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[120] See proposed Section 12(e)(3), which is materially identical to Cboe Rule 5.73(e)(3).

[121] See proposed Section 12(e)(4), which is based on Cboe Rule 5.73(e)(4) except the Exchange will replace Cboe's last priority feature with a guaranteed allocation feature similar to current PIM functionality that allows Members to request a lower percentage than their guaranteed allocation. See Options 3, Section 13(d)(3). The Exchange notes that the proposed guaranteed allocation percentages of 50% (if there is a response(s) from one other Member) and 40% (if there are responses from two or more Members) for FLEX PIM will differ from the current guaranteed allocation percentage of 40% for standard PIM. As such, the Exchange is aligning to Cboe's allocation percentages. The Exchange also notes that its affiliate, Nasdaq BX, Inc. ("BX"), has consistent guaranteed allocation percentages for its price improvement auction, BX PRISM. See BX Options 3, Section 13(ii)(A)(1).

[122] See Cboe Rule 5.73(e)(5) for substantially similar provisions.

genuine intention to execute a bona fide transaction.[123] Proposed Supplementary Material .02 will provide that it will be deemed conduct inconsistent with just and equitable principles of trade and a violation of Options 9, Section 1[124] to engage in a pattern of conduct where the Initiating Member breaks up an Agency Order into separate orders for the purpose of gaining a higher allocation percentage than the Initiating Member would have otherwise received in accordance with the allocation procedures contained in proposed paragraph (e) above.[125] Lastly, proposed Supplementary Material .03 will provide that if an allocation would result in less than one contract, then one contract will be allocated. This aligns to how the Exchange currently allocates contracts in PIM.[126]

N. FLEX SOM (Section 13)

The Exchange proposes to establish SOM auction functionality for FLEX Options in Options 3A, Section 13. The proposed FLEX SOM auction will be substantially similar to Cboe's FLEX SAM in Cboe Rule 5.74, except for certain intended differences to align with the Exchange's current System functionality for non-FLEX Options, as further described below. Pursuant to proposed Section 13, a Member (the "Initiating Member") may electronically submit for execution an order (which may be a simple or complex order) it represents as agent ("Agency Order") against a solicited order ("Solicited Order") if it submits the Agency Order for electronic execution into a FLEX SOM auction pursuant to this Rule.[127]

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123 See Cboe Rule 5.73, Interpretations and Policies .01 for materially identical provisions.

124 Options 9, Section 1 provides that no Member shall engage in acts or practices inconsistent with just and equitable principles of trade. Persons associated with Members shall have the same duties and obligations as Members under the Rules of Options 9.

125 See Cboe Rule 5.73, Interpretations and Policies .02 for materially identical provisions.

126 See Supplementary Material .10 to Options 3, Section 13.

127 See Cboe Rule 5.74 for similar provisions. The Exchange will not add Cboe's language that the Solicited Order cannot have a Capacity F for the same executing firm ID ("EFID") as the Agency Order because it will not System enforce the rejection of Firm capacity for the same badge/mnemonic as the Agency Order.

Proposed Section 13(a)(1) – (6) will set forth the FLEX SOM auction eligibility requirements, and will be substantially similar to Cboe Rule 5.74(a)(1) – (6) except as noted below. Specifically, the Initiating Member may initiate a FLEX SOM auction if all of the following conditions are met:

- **Class.** An Agency Order must in a FLEX Option class the Exchange designates as eligible for FLEX SOM auctions.
- **FLEX Option Series.** The Agency Order and Solicited Order must each be a FLEX Order that complies with proposed Section 11(a) in a permissible FLEX Option series that complies with proposed Section 3(b).
- **Marking.** The Initiating Member must mark an Agency Order for FLEX SOM auction processing.
- **Size.** The Agency Order must be for at least the minimum size designated by the Exchange (which may not be less than 500 standard option contracts). The Solicited Order must be for the same size as the Agency Order. The System handles each of the Agency Order and the Solicited Order as all-or-none.[128]
- **Minimum Increment.** The price of the Agency Order and Solicited Order for simple FLEX Orders must be in an increment the Exchange determines on a class basis (which may not be smaller than the amounts set forth in Section 5 above). If the Agency Order and Solicited Order are complex orders, the price must be a net

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Instead, it will to enforce the requirement that the contra-side order be a solicitation rather than a facilitation through surveillance, as it does today for non-FLEX SOM. The applicable rule for the foregoing requirement will be set forth in Supplementary Material .02 to Options 3A, Section 13.

128 See Cboe Rule 5.74(a)(4) for similar provisions except unlike Cboe, the Exchange will not allow the Solicited Order to be comprised of multiple solicited orders in FLEX SOM to be consistent with current non-FLEX SOM functionality in Options 3, Section 11(d). In addition, the Exchange will not incorporate Cboe's provisions relating to mini options or Micro FLEX Index Options into proposed Section 13(a)(4) as the Exchange does not list these products today.

price for the complex strategy.[129] While the Exchange will align to Cboe's minimum increment requirements (i.e., $0.01) for the individual options legs of a complex FLEX Order entered into a FLEX SOM, the Exchange also proposes to align the minimum increment requirements for stock-tied FLEX complex strategies with the existing requirements for stock-tied non-FLEX complex strategies as set forth in Options 3, Section 14(c)(1). As such, proposed Options 3A, Section 12(a)(5) will further provide that the prices of Complex Options Strategies (as defined in Options 3, Section 14) may be expressed in one cent ($0.01) increments, and the options leg of Complex Options Strategies may be executed in one cent ($0.01) increments, regardless of the minimum increments otherwise applicable to the individual options legs of the order. Prices of Stock-Option Strategies or Stock-Complex Strategies (each as defined in Options 3, Section 14) may be expressed in any decimal price determined by the Exchange,[130] and the stock leg of a Stock-Option Strategy or Stock-Complex Strategy may be executed in any decimal price permitted in the equity market. The options leg of a Stock-Option Strategy or Stock-Complex Strategy may be executed in one cent ($0.01) increments, regardless of the minimum increments otherwise applicable to the individual options legs of the order. Similar to stock-tied complex orders today, the Exchange believes that smaller minimum increments are appropriate for complex FLEX Orders that contain a stock

129 The Exchange notes that unlike Cboe, it will not allow prices to be entered as a percentage value, and therefore will not incorporate the applicable language from Cboe Rule 5.74(a)(5) into proposed Section 13(a)(5). As discussed above, the Exchange will also incorporate existing minimum increment requirements for non-FLEX complex orders into proposed Section 13(a)(5) to align the proposed FLEX functionality with non-FLEX functionality.

130 The minimum increment for Stock-Option Strategies and Stock-Complex Strategies can currently be expressed to four decimal places.

component as the stock component can trade at finer decimal increments permitted by the equity market.

- An Initiating Member may only submit an Agency Order to a FLEX SOM auction after trading in FLEX Options is open pursuant to proposed Section 8.

The System will reject or cancel both an Agency Order and Solicited Order submitted to a FLEX SOM auction that do not meet the conditions in proposed paragraph (a) as described above.

Pursuant to proposed Section 13(b), the Solicited Order must stop the entire Agency Order at a specified price. If the Agency Order and Solicited Order are complex orders, the price must be a net price for the complex strategy. The Initiating Member must specify a single price at which it seeks to execute the Agency Order against the Solicited Order. Otherwise, the System will reject or cancel both an Agency Order and Solicited Order submitted to a FLEX SOM auction that do not meet this condition.[131]

Proposed Section 13(c) will govern the FLEX SOM auction process. Specifically, upon receipt of an Agency Order that meets the conditions in paragraphs (a) and (b) as described above, the FLEX SOM auction process commences. Proposed subparagraphs (c)(1)(A) and (B) will describe concurrent FLEX SOM auctions for simple Agency Orders and complex Agency Orders, respectively, and will be materially identical to Cboe Rule 5.74(c)(1)(A) and (B).

One or more FLEX SOM auctions in the same FLEX Option series or same complex strategy (as applicable) may occur at the same time.[132] To the extent there is more than one

131 See Cboe Rule 5.74(b) for similar provisions, except the Exchange will not allow prices to be entered as a percentage value, and therefore will not incorporate the applicable language from Cboe's rule into proposed Section 13(b).

132 Further, for complex Agency Orders, SOM auctions in different complex strategies may be ongoing at any given time, even if the complex strategies have overlapping components. A FLEX SOM auction in a

FLEX SOM auction in a FLEX Option series or complex strategy (as applicable) underway at the same time, the FLEX SOM auctions will conclude sequentially based on the times at which the FLEX SOM auction periods end. At the time each FLEX SOM auction concludes, the System allocates the Agency Order pursuant to proposed paragraph (e) as described below, and takes into account all FLEX SOM responses received during the FLEX SOM auction period. As noted above, the proposed concurrent FLEX SOM auction feature is consistent with Cboe's concurrent FLEX SAM auctions feature in Cboe Rule 5.74(c)(1), and is also consistent with the concurrent auction feature proposed above for FLEX Auctions and FLEX PIM. For the same reasons stated above for FLEX Auctions and FLEX PIM, the Exchange believes that providing this concurrent auction functionality for FLEX SOM may provide additional opportunities for execution of FLEX Orders by encouraging Members to use FLEX SOM.

Pursuant to proposed Section 13(c)(2), the System initiates the FLEX SOM auction process by sending a FLEX SOM auction notification message detailing the side, size, price, capacity, auction ID, the length of the FLEX SOM auction period, and FLEX Option series or complex strategy, as applicable, of the Agency Order to all Members that elect to receive FLEX SOM auction notification messages. FLEX SOM auction notification messages will not be disseminated to OPRA. These provisions are materially identical to Cboe Rule 5.74(c)(2).

Proposed Section 13(c)(3) will describe the "FLEX SOM Auction period," and is based on Cboe Rule 5.74(c)(3). The FLEX SOM Auction period will be defined as a period of time that must be designated by the Initiating Member, which may be no less than three seconds and no more than five minutes. Similar to the exposure interval for electronic FLEX Auctions in Section 11(b) and the FLEX PIM Auction period in Section 12(c)(3) as discussed above, the

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complex strategy may be ongoing at the same time as a FLEX SOM auction in any component of the complex strategy. See proposed subparagraph (c)(1)(B)(i) of Options 3A, Section 13.

Initiating Member will be required to identify a length of time within the specified parameters for FLEX SOM as there will be no default for the FLEX SOM Auction period. Otherwise, their FLEX Order will be rejected by the System. Further, if the designated length of the FLEX SOM Auction period exceeds the market close, then the auction will end at the market close with an execution, if an execution is permitted by this Section 13. Cboe's rule does not specify whether an execution (if permitted) would occur if the designated length exceeds the market close. However, the Exchange's non-FLEX auctions currently allow executions (as permitted by their respective rules) to occur in such scenarios, so the Exchange proposes to be consistent with current System functionality in this regard.[133] In doing so, the Exchange's proposal will promote executions in FLEX SOM while also preventing executions after the market close.

Proposed Section 13(c)(4) will provide that an Initiating Member may not modify an Agency Order or Solicited Order after submission to a FLEX SOM auction. This will be similar to Cboe Rule 5.74(c)(4) except unlike Cboe, the Exchange will allow Initiating Members to cancel their Agency Orders and Solicited Orders upon submission into a FLEX SOM, which will align with current SOM functionality.[134]

Proposed Section 13(c)(5) will govern the requirements for FLEX SOM responses. Specifically:

- Any Member other than the Initiating Member (the response cannot have the same badge/mnemonic as the Agency Order) may submit responses to a FLEX SOM auction that are properly marked specifying size, side, price, and the auction ID for the FLEX SOM auction to which the Member is submitting the response.

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[133] While this behavior is not explicitly stated in the current Rules, the Exchange's proposal will be consistent with current non-FLEX auction behavior, including current PIM and SOM behavior.

[134] This feature is not explicitly stated in the current SOM rules in Options 3, Section 11(d), but it is consistent with current SOM functionality.

A FLEX SOM response may only participate in the FLEX SOM auction with the auction ID specified in the response.[135]

- The minimum price increment for FLEX SOM responses is the same as the one the Exchange determines for a class pursuant to proposed Section 12(a)(5) above. A response to a FLEX SOM auction of a complex Agency Order must have a net price. The System will reject a FLEX SOM response that is not in the applicable minimum increment.[136]
- A Member using the same badge/mnemonic may only submit a single FLEX SOM response per auction ID for a given auction. If an additional SOM response is submitted for the same auction ID from the same badge/mnemonic, then that FLEX SOM response will automatically replace the previous FLEX SOM response.[137]
- The System will cap the size of a FLEX SOM response at the size of the Agency Order (i.e., the System will ignore size in excess of the size of the Agency Order when processing the FLEX SOM auction).[138]

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135 See proposed Options 3A, Section 13(c)(5), which is based on Cboe Rule 5.74(c)(5).

136 See proposed Options 3A, Section 13(c)(5)(A), which is based on Cboe Rule 5.74(c)(5)(A) except the Exchange will not allow prices to be expressed as a percentage value.

137 See proposed Options 3A, Section 13(c)(5)(B), which will be different from Cboe Rule 5.74(c)(5)(B) because the Exchange will not allow Members to submit multiple FLEX SOM responses using the same badge/mnemonic, and will not aggregate all of the Member's FLEX SOM responses. While the rules are currently silent in this regard, the proposed language will align to current non-FLEX auction functionality, including SOM auctions in Options 3, Section 11(d).

138 See proposed Options 3A, Section 13(c)(5)(C), which is based on Cboe Rule 5.74(c)(5)(C) except the Exchange will not allow Members to submit multiple FLEX SOM responses using the same badge/mnemonic, and will not aggregate all of the Member's FLEX SOM responses. As noted above, this will align to current non-FLEX auction functionality, including SOM auctions in Options 3, Section 11(d).

- FLEX SOM responses must be on the opposite side of the market as the Agency Order. The System rejects a FLEX SOM response on the same side of the market as the Agency Order.[139]
- FLEX SOM responses will not be visible to FLEX SOM auction participants or disseminated to OPRA.[140]
- A Member may modify or cancel its FLEX SOM responses during a FLEX SOM auction.[141]

Pursuant to proposed Section 13(d), a FLEX SOM auction concludes at the earliest to occur of the following times: (1) the end of the FLEX SOM auction period; and (2) any time the Exchange halts trading in the affected series, provided, however, that in such instance the FLEX SOM auction concludes without execution.[142]

Proposed Section 13(e) will govern how executions will occur in FLEX SOM. In particular, at the end of the FLEX SOM auction, the System will execute the Agency Order against the Solicited Order or FLEX SOM responses at the best price(s) as follows. For purposes of ranking the Solicited Order and FLEX SOM responses when determining how to allocate the Agency Order against the Solicited Order and those responses, the term "price" refers to the dollar and decimal amount of the order or response bid or offer.[143] Proposed subparagraphs (e)(1) – (3) details the FLEX SOM allocation methodology for the following scenarios:

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139 See proposed Options 3A, Section 13(c)(5)(D), which is materially identical to Cboe Rule 5.74(c)(5)(D).

140 See proposed Options 3A, Section 13(c)(5)(E), which is materially identical to Cboe Rule 5.74(c)(5)(E).

141 See proposed Options 3A, Section 13(c)(5)(F), which is materially identical to Cboe Rule 5.74(c)(5)(F).

142 See Cboe Rule 5.74(d) for materially identical provisions.

143 See Cboe Rule 5.74(e) for similar provisions except the Exchange will not allow prices to be expressed as a percentage value.

- **Execution Against Solicited Order**: The System executes the Agency Order against the Solicited Order at the stop price if there are no Priority Customer FLEX SOM responses and the aggregate size of FLEX SOM responses at an improved price(s) is insufficient to satisfy the Agency Order.[144]
- **Execution Against FLEX SOM Responses**: The System executes the Agency Order against FLEX SOM responses if (1) there is a Priority Customer FLEX SOM response and the aggregate size of that response and all other FLEX SOM responses is sufficient to satisfy the Agency Order or (2) the aggregate size of FLEX SOM responses at an improved price(s) is sufficient to satisfy the Agency Order. The Agency Order executes against FLEX SOM responses at each price level. At the price at which the balance of the Agency Order can be fully executed, in the following order:
    - Priority Customer FLEX SOM responses (in time priority);[145] and
    - All other FLEX SOM responses, allocated on a Size Pro-Rata basis (as defined in Options 3, Section 10(c)).[146]
- **No Execution**: The System will cancel the Agency Order and Solicited Order with no execution if there is a Priority Customer FLEX SOM response and the aggregate size of that response and other FLEX SOM responses is insufficient to satisfy the Agency Order.[147]

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144 See proposed Section 13(e)(1), which is materially identical to Cboe Rule 5.74(e)(1).

145 See proposed Section 13(e)(2)(A), which is materially identical to Cboe Rule 5.74(e)(2)(A).

146 See proposed Section 13(e)(2)(B), which is materially identical to Cboe Rule 5.74(e)(2)(B). The Exchange notes that Size Pro-Rata (as defined in Options 3, Section 10(c)) is similar to pro-rata as referenced in the Cboe rule (and as defined in Cboe Rule 5.32(a)(1)(B)).

147 See proposed Section 13(e)(3), which is materially identical to Cboe Rule 5.74(e)(3).

Pursuant to proposed Section 12(e)(4), the System cancels any unexecuted FLEX SOM responses (or unexecuted portions) at the conclusion of a FLEX SOM auction.[148]

Lastly, the Exchange proposes a number of policies applicable to FLEX SOM as Supplementary Materials to Options 3A, Section 13. Specifically, proposed Supplementary Material .01 will provide that prior to entering Agency Orders into a FLEX SOM auction on behalf of customers, Initiating Members must deliver to the customer a written notification informing the customer that its order may be executed using the FLEX SOM Auction. The written notification must disclose the terms and conditions contained in this Rule and be in a form approved by the Exchange.[149] Proposed Supplementary Material .02 will provide that under this Rule, Initiating Members may enter contra-side orders that are solicited. FLEX SOM provides a facility for Members that locate liquidity for their customer orders. Members may not use the FLEX SOM auction to circumvent Options 3, Section 22(b) limiting principal transactions. This may include, but is not limited to, Members entering contra-side orders that are solicited from (1) affiliated broker-dealers, or (2) broker-dealers with which the Member has an arrangement that allows the Member to realize similar economic benefits from the solicited transaction as it would achieve by executing the customer order in whole or in part as principal. Additionally, any solicited contra-side orders entered by Members to trade against Agency Orders may not be for the account of an Exchange Market Maker that is assigned to the options class.[150] Lastly, proposed Supplementary Material .03 will provide that if an allocation would

148 See Cboe Rule 5.74(e)(4) for substantially similar provisions.

149 See Cboe Rule 5.74, Interpretations and Policies .01 for materially identical provisions.

150 See Cboe Rule 5.74, Interpretations and Policies .02 for similar provisions. The Exchange is also adding a prohibition against solicited contra-side orders being for the account of an Exchange Market Maker assigned to the options class to align with the current prohibition in Supplementary Material .03 to Options 3, Section 11.

result in less than one contract, then one contract will be allocated. This aligns to how the Exchange currently allocates contracts in SOM.[151]

O. Risk Protections (Section 14)

The Exchange proposes in Options 3A, Section 14 to specify which of the Exchange's risk protections apply to FLEX trading. Proposed Section 14(a) will provide that the following simple order risk protections (as described in Options 3, Section 15) are available to FLEX Options: Market Wide Risk Protection[152] and Size Limitation.[153] Proposed Section 14(b) will provide that the following complex order risk protections (as described in Options 3, Section 16) are available to FLEX Options: Strategy Protections (only to FLEX Auctions and FLEX responses in proposed Options 3A, Section 11(b))[154] and Size Limitation.[155] Today, Strategy Protections do not apply to orders and responses submitted into non-FLEX PIM and non-FLEX SOM. The Exchange will align this application to FLEX such that Strategy Protections would only apply to FLEX Auctions and FLEX responses in proposed Section 11(b) as described above, and not to FLEX Orders and responses submitted into FLEX PIM and FLEX SOM.

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[151] See Supplementary Material .09 to Options 3, Section 11.

[152] Market Wide Risk Protection are mandatory activity-based protections that establish limits for order entry and order execution rate. Upon triggering the specified limits, the System will either delete all open orders and prevent entry of new orders for the Member, or prevent entry of new orders for the Member. See Options 3, Section 15(a)(1)(C).

[153] Size Limitation for simple orders is a limit on the number of contracts an incoming order may specify. Orders that exceed the maximum number of contracts are rejected. The maximum number of contracts, which shall not be less than 10,000, is established by the Exchange from time-to-time. See Options 3, Section 15(a)(2)(B).

[154] The Strategy Protections in Options 3, Section 16(b) as the Vertical Spread Protection, Calendar Spread Protection, Butterfly Spread Protection, and Box Spread Protection, and are aimed at preventing the potential execution of certain complex strategies outside of specified price parameters.

[155] Size Limitation for complex orders is a limit on the number of contracts (and shares in the case of a Stock-Option Strategy or Stock-Complex Strategy) any single leg of an incoming Complex Order may specify. Orders that exceed the maximum number of contracts (or shares) are rejected. The maximum number of contracts (or shares), which shall not be less than 10,000 (or 100,000 shares), is established by the Exchange from time-to-time. See Options 3, Section 16 (c)(2).

Proposed Section 14(c) will provide that the optional risk protections in Options 3, Section 28 are available to FLEX Options.[156]

P. Data Feeds (Section 15)

The Exchange proposes to specify in Options 3A, Section 15 which data feeds it will disseminate auction notifications for simple and complex FLEX Orders. Proposed Section 15(a) will provide that auction notifications for simple FLEX Orders will be disseminated through the Order Feed, as described in Options 3, Section 23(a)(2).[157] Proposed Section 15(b) will provide that auction notifications for complex FLEX Orders will be disseminated through the Spread Feed, as described in Options 3, Section 23(a)(5).[158] The Exchange notes that this aligns to current functionality where simple auction notifications are disseminated over the Order Feed and complex auction notifications are disseminated over the Spread Feed.

Q. FLEX Market Makers (Section 16)

Proposed Section 16 will govern FLEX Market Makers on the Exchange. Pursuant to proposed Section 16(a), a FLEX Market Maker will automatically receive an appointment in the same FLEX option class(es) as its non-FLEX class appointments selected pursuant to Options 2,

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156 The Exchange will introduce the optional risk protections in Options 3, Section 28 as part of the technology migration to enhanced Nasdaq functionality discussed above. In particular, the following are optional risk protections in Options 3, Section 28: notional dollar value per order, daily aggregate notional dollar value, quantity per order, and daily aggregate quantity. See Securities Exchange Act Releases No. 96818 (February 6, 2023), 88 FR 8950 (February 10, 2023) (SR-ISE-2023-06).

157 The Nasdaq ISE Order Feed ("Order Feed") provides information on new orders resting on the book (e.g. price, quantity and market participant capacity). In addition, the feed also announces all auctions. The data provided for each option series includes the symbols (series and underlying security), put or call indicator, expiration date, the strike price of the series, and whether the option series is available for trading on ISE and identifies if the series is available for closing transactions only. The feed also provides order imbalances on opening/reopening.

158 Nasdaq ISE Spread Feed ("Spread Feed") is a feed that consists of: (1) options orders for all Complex Orders (i.e., spreads, buy-writes, delta neutral strategies, etc.); (2) data aggregated at the top five price levels (BBO) on both the bid and offer side of the market; (3) last trades information. The Spread Feed provides updates, including prices, side, size and capacity, for every Complex Order placed on the ISE Complex Order book. The Spread Feed shows: (1) aggregate bid/ask quote size; (2) aggregate bid/ask quote size for Professional Customer Orders; and (3) aggregate bid/ask quote size for Priority Customer Orders for ISE traded options. The feed also provides Complex Order auction notifications.

Section 3.[159] Only the Primary Market Maker in the non-FLEX Option may be the assigned Primary Market Maker in that FLEX Option.[160]

Proposed Section 16(b) will provide that each FLEX Market Maker must fulfill all the obligations of a Market Maker under Options 2 and must comply with the applicable provisions, except FLEX Market Makers do not need to provide continuous quotes in FLEX Options.[161]

R. Letters of Guarantee (Section 17)

The Exchange proposes in Options 3A, Section 17(a) to provide that no FLEX Market Maker shall effect any transaction in FLEX Options unless one or more effective Letter(s) of Guarantee has been issued by a Clearing Member and filed with the Exchange accepting financial responsibility for all FLEX transactions made by the FLEX Market Maker pursuant to Options 6, Section 4.[162]

S. Position Limits (Section 18)

The Exchange proposes to detail the position limits for FLEX Options in Options 3A, Section 18. As discussed below, proposed Section 18 will be based on the FLEX Options position limit rules on Cboe and Phlx.

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159 See Cboe Rule 3.58(c) for materially identical provisions.

160 The Exchange notes that this requirement is based on Phlx Options 8, Section 34(d)(1), which currently states that only the Lead Market Maker in the non-FLEX option may be the assigned Specialist in that FLEX option. Primary Market Maker on ISE is analogous to a Lead Market Maker on Phlx.

161 See Cboe Rule 5.57 for similar provisions. Unlike Cboe, the Exchange will not specify that a FLEX Market Maker may (but is not obligated to) respond to a FLEX auction in a class in which the FLEX Market Maker is appointed. FLEX Market Makers will be subject to Options 2 rules pertaining to Market Makers, except the Exchange will not impose continuing quoting obligations on FLEX Market Makers (similar to Cboe) given that such obligations are relevant for book trading. As discussed above, there will be no book trading for FLEX Options. Furthermore, the Exchange will not incorporate provisions related to FLEX Officials like Cboe as this is generally a floor trading concept and the Exchange does not have a trading floor.

162 Options 6, Section 4 provides that no Market Maker shall make any transactions on the Exchange unless a Letter of Guarantee has been issued for such Member by a Clearing Member and filed with the Exchange, and unless such Letter of Guarantee has not been revoked pursuant to paragraph (c) of this Rule. A Letter of Guarantee shall provide that the issuing Clearing Member accepts financial responsibilities for all Exchange Transactions made by the guaranteed Member.

Proposed Section 18(a) will govern the position limits for FLEX Index Options. Specifically, proposed Section 18(a)(1) will provide that except as provided in proposed Section 18(a)(2) – (3) below, FLEX Index Options shall be subject to the same position limits governing index options as provided for in Options 4A, Sections 6 and 7.[163] Proposed Section 18(a)(2) will provide that except for the broad-based index options listed in Options 4A, Section 6(a),[164] which will have no position limits for FLEX Index Options, broad-based FLEX Index Options will be subject to a separate position limit of 200,000 contracts on the same side of the market.[165] Proposed Section 18(a)(3) will provide that industry-based FLEX Index Options shall be subject to separate position limits of 36,000, 48,000, or 60,000 contracts, depending on the position limit tier determined pursuant to Options 4A, Section 7(a)(1).[166]

Proposed Section 18(b) will govern the position limits for FLEX Equity Options. Pursuant to proposed Section 18(b)(1)(A), there will generally be no position limits for FLEX Equity Options.[167] Pursuant to proposed Section 18(b)(2), each Member (other than a Market Maker) that maintains a position on the same side of the market in excess of the standard limit under Options 9, Section 13 for non-FLEX Equity Options of the same class on behalf of its own account or for the account of a customer shall report information on the FLEX Equity option

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163 See Phlx Options 8, Section 34(e)(1) for materially identical provisions. Options 4A, Sections 6 and 7 presently set forth the position limits for broad-based and industry index options, respectively.

164 As such the following broad-based index options listed in Options 4A, Section 6(a) will have no position limits for FLEX Index Options: options on the Nasdaq 100 Index, Mini Nasdaq 100 Index, Nations VolDex Index, Nasdaq 100 Reduced Value Index, and Nasdaq Micro Index Options.

165 This separate same side position limit for broad-based FLEX Index Options (except for the ones noted above) is based on Phlx Options 8, Section 34(e)(1). The Exchange notes that market index options, as referenced in the Phlx rule, is the equivalent of broad-based index options on the Exchange.

166 See Phlx Options 8, Section 34(e)(1) for materially identical provisions.

167 See Cboe Rule 8.35(c)(1)(A) for materially identical provisions. Like Cboe, the Exchange's rule will have exceptions for the aggregation of FLEX positions (proposed Section 18(c)) and for position limits for cash-settled FLEX Equity Options where the underlying security is an ETF (proposed Section 18(b)(1)(B), which will be discussed later in this filing).

position, positions in any related instrument, the purpose or strategy for the position, and the collateral used by the account. This report shall be in the form and manner prescribed by the Exchange.[168] Pursuant to proposed Section 18(b)(3), whenever the Exchange determines that a higher margin requirement is necessary in light of the risks associated with a FLEX Equity option position in excess of the standard limit for non-FLEX Equity options of the same class, the Exchange may consider imposing additional margin upon the account maintaining such under-hedged position, pursuant to its authority under Options 6C, Section 5.[169] Additionally, it should be noted that the clearing firm carrying the account will be subject to capital charges under Rule 15c3-1 under the Exchange Act to the extent of any margin deficiency resulting from the higher margin requirement.[170]

Proposed Section 18(c) will govern the aggregation of FLEX positions. Specifically, for purposes of the position limits and reporting requirements set forth in this Section 18, FLEX Option positions shall not be aggregated with positions in non-FLEX Options other than as provided in this Section 18(c) and in Section(b)(1)(B),[171] and positions in FLEX Index Options on a given index shall not be aggregated with options on any stocks included in the index or with FLEX Index Option positions on another index.[172] Pursuant to proposed Section 18(c)(1), commencing at the close of trading two business days prior to the last trading day of the calendar quarter, positions in P.M.-settled FLEX Index Options (i.e., FLEX Index Options having an

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168 See Cboe Rule 8.35(c)(2) for materially identical provisions.

169 Options 6C, Section 5 provides that the amount of margin prescribed by these Rules is the minimum which must be required initially and subsequently maintained with respect to each account affected thereby; but nothing in these Rules shall be construed to prevent a Member from requiring margin in an amount greater than that specified. Further, the Exchange may at any time impose higher margin requirements with respect to such positions when it deems such higher margin requirements to be advisable.

170 See Cboe Rule 8.35(c)(3) for materially identical provisions.

171 Proposed Section 18(b)(1)(B) will set forth the position limits for cash-settled FLEX ETF options and will be discussed later in this filing.

172 See Cboe Rule 8.35(d) for materially identical provisions.

exercise settlement value determined by the level of the index at the close of trading on the last trading day before expiration) shall be aggregated with positions in Quarterly Options Series on the same index with the same expiration and shall be subject to the position limits set forth in Options 4A, Section 6 or Section 7, as applicable.[173] Pursuant to proposed Section 18(c)(2), commencing at the close of trading two business days prior to the last trading day of the week, positions in FLEX Index Options that are cash settled shall be aggregated with positions in Short Term Option Series on the same underlying (e.g., same underlying index as a FLEX Index Option) with the same means for determining exercise settlement value (e.g., opening or closing prices of the underlying index) and same expiration, and shall be subject to the position limits set forth in Options 4A, Section 6 or Section 7, as applicable.[174] Pursuant to proposed Section 18(c)(3), as long as the options positions remain open, positions in FLEX Options that expire on a third Friday-of-the-month expiration day shall be aggregated with positions in non-FLEX Options on the same underlying, and shall be subject to the position limits set forth in Options 4A, Section 6, Options 4A, Section 7, or Options 9, Section 13, as applicable, and the exercise limits set forth in Options 9, Section 15, as applicable.[175]

T. Exercise Limits (Section 19)

The Exchange proposes to detail the exercise limits for FLEX Options in Options 3A, Section 19. As discussed below, proposed Section 19 will be based on the FLEX Options exercise limit rules on Cboe and Phlx.

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173 See Cboe Rule 8.35(d)(1) for materially identical provisions.

174 This is based on Cboe Rule 8.35(d)(2), except the Exchange does not currently list Credit Default Options and will therefore not incorporate the applicable portion into its proposed rule.

175 See Cboe Rule 8.35(d)(3) for materially identical provisions.

Proposed Section 19(a) will provide that exercise limits for FLEX Options shall be equivalent to the FLEX position limits prescribed in proposed Section 18.[176] There shall be no exercise limits for broad-based FLEX Index Options (including reduced value option contracts) on broad-based index options listed in Options 4A, Section 6(a).[177]

Proposed Section 19(a)(1) will require that the minimum value size for FLEX Equity Option exercises be 25 contracts or the remaining size of the position, whichever is less.[178] Proposed Section 19(a)(2) will require that the minimum value size for FLEX Index Option exercises be $1 million Underlying Equivalent Value (as defined below) or the remaining Underlying Equivalent Value of the position, whichever is less.[179] Proposed Section 19(a)(3) will stipulate that except as provided in proposed Section 18(b)(1)(B) and Section 18(c) above,[180] FLEX Options shall not be taken into account when calculating exercise limits for non-FLEX Option contracts.[181] Lastly, proposed Section 19(a)(4) will set forth the definition of Underlying Equivalent Value as the aggregate value of a FLEX Index Option (index multiplier times the current index value) multiplied by the number of FLEX Index Options.[182]

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176 Proposed Section 19(a) is based on Cboe Rule 8.42(g) except the Exchange will not incorporate references to Cboe-specific products like Micro FLEX Index Options, FLEX Individual Stock or ETF Based Volatility Index Options. Similarly, the Exchange will replace the references to Cboe-specific broad-based index options like SPX, VIX, etc. with the broad-based index options in Options 4A, Section 6(a).

177 As such the following broad-based index options listed in Options 4A, Section 6(a) will have no exercise limits for FLEX Index Options: options on the Nasdaq 100 Index, Mini Nasdaq 100 Index, Nations VolDex Index, Nasdaq 100 Reduced Value Index, and Nasdaq Micro Index Options.

178 See Cboe Rule 8.42(g)(1) for materially identical provisions.

179 See Cboe Rule 8.42(g)(2) for materially identical provisions.

180 As described above, proposed Section 18(c) will govern the aggregation of FLEX positions generally, while proposed Section 18(b)(1)(B) will govern the aggregation of cash-settled FLEX Equity Options specifically. Cash-settled FLEX Equity Options will be discussed later in this filing.

181 See Cboe Rule 8.42(g)(3) for materially identical provisions.

182 See Phlx Options 8, Section 34(b)(8)(D) for materially identical provisions.

U. Capacity and Surveillances

The Exchange has analyzed its capacity and represents that it believes the Exchange and the Options Price Reporting Authority ("OPRA") have the necessary systems capacity to handle the additional message traffic associated with the listing of new series that may result from the introduction of FLEX Options.[183]

Additionally, the Exchange believes it has an adequate surveillance program in place and intends to apply the same program procedures to FLEX Options that is applied to the Exchange's other options products, as applicable. FLEX Option products and their respective symbols will be integrated into the Exchange's existing surveillance system architecture and will be subject to the relevant surveillance processes. The Exchange believes that any potential risk of manipulative activity is mitigated by these existing surveillance technologies, procedures, and reporting requirements, which allow the Exchange to properly identify disruptive and/or manipulative trading activity.

V. Cash-Settled FLEX ETFs

The Exchange proposes to include rule text in proposed Options 3A, Section 3(c) and Section 18, each as discussed above, to allow for cash settlement of certain FLEX Equity Options. Generally, as discussed above, FLEX Equity Options will be settled by physical delivery of the underlying security,[184] while all FLEX Index Options will be settled by delivery in cash.[185] The Exchange proposes to allow FLEX Equity Options where the underlying security is an ETF to be settled by delivery in cash if the underlying security meets prescribed criteria. The Exchange notes that cash-settled FLEX ETF Options will be subject to the same trading

183 The Exchange will report FLEX Option trades and, if necessary, trade cancellations to OPRA.

184 See proposed Options 3A, Section 3(c)(5)(A)(i).

185 See proposed Options 3A, Section 3(c)(5)(B). As discussed below, cash settlement is also permitted in the OTC market.

rules and procedures described above that will govern the trading of other FLEX Options on the Exchange, with the exception of the rules to accommodate the cash-settlement feature proposed as follows. Today, NYSE American Rule 903G[186] and Cboe Rule 4.21(b)(5)(A)[187] allow for cash-settled FLEX ETF Options as well.

To permit cash settlement of certain FLEX ETF Options, the Exchange proposes rule text in Section 3(c)(5)(A)(ii) to provide that the exercise settlement for a FLEX ETF Option may be by physical delivery of the underlying ETF or by delivery in cash if the underlying security, measured over the prior six-month period, has an average daily notional value of $500 million or more and a national average daily volume ("ADV") of at least 4,680,000 shares.[188]

The Exchange also proposes in Section 3(c) that a FLEX Equity Option overlying an ETF (cash- or physically-settled) may not be the same type (put or call) and may not have the same exercise style, expiration date, and exercise price as a non-FLEX Equity Option overlying the same ETF.[189] In other words, regardless of whether a FLEX Equity Option overlying an ETF is cash or physically settled, at least one of the exercise style (i.e., American-style or European-style), expiration date, and exercise price of that FLEX Option must differ from those terms of a non-FLEX Option overlying the same ETF in order to list such a FLEX Equity Option. For example, suppose a non-FLEX SPY option (which is physically settled, p.m.-settled and

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186 See Securities Exchange Act Release No. 88131 (February 5, 2020), 85 FR 7806 (February 11, 2020) (SR-NYSEAmer-2019-38) (Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, To Allow Certain Flexible Equity Options To Be Cash Settled).

187 Cboe also recently filed to allow certain FLEX Options to be cash settled. See Securities Exchange Act Release No. 98044 (August 2, 2023), 88 FR 53548 (August 8, 2023) (SR-Cboe-2023-036) (Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Allow Certain Flexible Exchange Equity Options To Be Cash Settled).

188 See Cboe Rule 4.21(b)(5)(A)(ii) for materially identical provisions.

189 See introductory paragraph of Cboe Rule 4.21(b) for materially identical provisions. All non-FLEX Equity Options (including on ETFs) are physically settled. Note all FLEX and non-FLEX Equity Options (including ETFs) are p.m.-settled.

American-style) with a specific September expiration and exercise price of 475 is listed for trading. A FLEX Trader could not submit an order to trade a FLEX SPY option (which is p.m.-settled) that is cash-settled (or physically settled) and American-style with the same September expiration and exercise price of 475.

In addition, the Exchange proposes new subparagraph (a) to Section 3(c)(5)(A)(ii), which would provide that the Exchange will determine bi-annually the underlying ETFs that satisfy the notional value and trading volume requirements in Section 3(c)(5)(A)(ii) by using trading statistics for the previous six-month period.[190] The proposed rule would further provide that the Exchange will permit cash settlement as a contract term on no more than 50 underlying ETFs that meet the criteria in this subparagraph (ii) and that if more than 50 underlying ETFs satisfy the notional value and trading volume requirements, then the Exchange would select the top 50 ETFs that have the highest average daily volume.[191]

Proposed new subparagraph (b) to Section 3(c)(5)(A)(ii) would further provide that if the Exchange determines pursuant to the bi-annual review that an underlying ETF ceases to satisfy the requirements under proposed Section 3(c)(5)(A)(ii), any new position overlying such ETF entered into will be required to have exercise settlement by physical delivery, and any open cash-settled FLEX ETF Option positions may be traded only to close the position.[192]

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190 See proposed Options 3A, Section 3(c)(5)(A)(ii)(a), which is based on Cboe Rule 4.21(b)(5)(A)(ii)(a). The Exchange plans to conduct the bi-annual review on January 1 and July 1 of each year. The results of the bi-annual review will be announced via an Options Trader Alert and any new securities that qualify would be permitted to have cash settlement as a contract term beginning on February 1 and August 1 of each year. If the Exchange initially begins listing cash-settled FLEX Equity Options on a different date (e.g., September 1), it would initially list securities that qualified as of the last bi-annual review (e.g., the one conducted on July 1).

191 See proposed Options 3A, Section 3(c)(5)(A)(ii)(a), which is based on Cboe Rule 4.21(b)(5)(A)(ii)(a).

192 See proposed Section 3(c)(5)(A)(ii)(b), which is based on Cboe Rule 4.21(b)(5)(A)(ii)(b). If a listing is closing only, pursuant to Options 4, Section 4(a), opening transactions by Market Makers executed to accommodate closing transactions of other market participants are permitted.

The Exchange believes it is appropriate to introduce cash settlement as an alternative contract term to the select group of ETFs because they are among the most highly liquid and actively traded ETF securities. As described more fully below, the Exchange believes that the deep liquidity and robust trading activity in the ETFs identified by the Exchange as meeting the criteria mitigate against historic concerns regarding susceptibility to manipulation.

Characteristics of ETFs

ETFs are funds that have their value derived from assets owned. The net asset value ("NAV") of an ETF is a daily calculation that is based off the most recent closing prices of the assets in the fund and an actual accounting of the total cash in the fund at the time of calculation. The NAV of an ETF is calculated by taking the sum of the assets in the fund, including any securities and cash, subtracting out any liabilities, and dividing that by the number of shares outstanding.

Additionally, each ETF is subject to a creation and redemption mechanism to ensure the price of the ETF does not fluctuate too far away from its NAV -- which mechanisms reduce the potential for manipulative activity. Each business day, ETFs are required to make publicly available a portfolio composition file that describes the makeup of their creation and redemption "baskets" (i.e., a specific list of names and quantities of securities or other assets designed to track the performance of the portfolio as a whole). ETF shares are created when an Authorized Participant, typically a market maker or other large institutional investor, deposits the daily creation basket or cash with the ETF issuer. In return for the creation basket or cash (or both), the ETF issues to the Authorized Participant a "creation unit" that consists of a specified number of ETF shares. For instance, IWM is designed to track the performance of the Russell 2000 Index. An Authorized Participant will purchase all the Russell 2000 constituent securities in the exact same weight as the index prescribes, then deliver those shares to the ETF issuer. In exchange, the ETF issuer gives the Authorized Participant a block of equally valued ETF shares, on a one-for-one fair value basis. This process can also work in reverse. A redemption is achieved when the Authorized Participant accumulates a sufficient number of shares of the ETF to constitute a creation unit and then exchanges these ETF shares with the ETF issuer, thereby decreasing the supply of ETF shares in the market.

The principal, and perhaps most important, feature of ETFs is their reliance on an "arbitrage function" performed by market participants that influences the supply and demand of ETF shares and, thus, trading prices relative to NAV. As noted above, new ETF shares can be created and existing shares redeemed based on investor demand; thus, ETF supply is open-ended. This arbitrage function helps to keep an ETF's price in line with the value of its underlying portfolio, i.e., it minimizes deviation from NAV. Generally, in the Exchange's view, the higher the liquidity and trading volume of an ETF, the more likely the price of the ETF will not deviate from the value of its underlying portfolio, making such ETFs less susceptible to price manipulation.

Trading Data for the ETFs Proposed for Cash Settlement

The Exchange believes that average daily notional value is an appropriate proxy for selecting underlying securities that are not readily susceptible to manipulation for purposes of establishing a settlement price. Average daily notional value considers both the trading activity and the price of an underlying security. As a general matter, the more expensive an underlying security's price, the less cost-effective manipulation could become. Further, manipulation of the price of a security encounters greater difficulty the more volume that is traded. To calculate average daily notional value (provided in the table below), the Exchange summed the notional value of each trade for each symbol (i.e., the number of shares times the price for each execution in the security) and divided that total by the number of trading days in the six-month period (from June 1, 2023 through December 31, 2023) reviewed by the Exchange.

Further, the Exchange proposes that qualifying ETFs also meet an ADV standard. The purpose for this second criteria is to prevent unusually expensive underlying securities from qualifying under the average daily notional value standard while not being one of the most actively traded securities. The Exchange believes an ADV requirement of 4,680,000 shares a day is appropriate because it represents average trading in the underlying ETF of 200 shares per second. While no security is immune from all manipulation, the Exchange believes that the combination of average daily notional value and ADV as prerequisite requirements would limit cash settlement of FLEX ETF Options to those underlying ETFs that would be less susceptible to manipulation in order to establish a settlement price.

The Exchange believes that the proposed objective criteria would ensure that only the most robustly traded and deeply liquid ETFs would qualify to have cash settlement as a contract term. As provided in the below table, as of December 31, 2023, the Exchange would be able to provide cash settlement as a contract term for FLEX ETF Options on 39 underlying ETFs, as only this group of securities would currently meet the requirement of $500 million or more average daily notional value and a minimum ADV of 4,680,000 shares. The table below provides the list of the 39 ETFs that, as of December 31, 2023, would be eligible to have cash settlement as a contract term.

Symbol	Security Name	Average Daily Notional Value (in dollars) (6/1/23 - 12/31/23)	Average Daily Volume (in shares) (6/1/23 - 12/31/23)
AGG	iShares Core U.S. Aggregate Bond ETF	$819,003,505	8,539,037
ARKK	ARK Innovation ETF	$707,292,851	16,154,806
BIL	SPDR Bloomberg 1-3 Month T-Bill ETF	$762,676,069	8,326,055
EEM	iShares MSCI Emerging Markets ETF	$1,162,016,698	29,631,030
EFA	iShares MSCI EAFE ETF	$1,098,301,530	15,452,387
EWZ	iShares MSCI Brazil ETF	$761,109,830	23,812,637
FXI	iShares China Large-Cap ETF	$894,787,224	33,669,717
GDX	VanEck Gold Miners ETF	$618,321,580	20,914,982
GLD	SPDR Gold Shares	$1,253,006,545	6,922,775
HYG	iShares iBoxx $ High Yield Corporate Bond ETF	$2,903,997,736	39,043,244
IEF	iShares 7-10 Year Treasury Bond ETF	$894,889,766	9,586,765
IEFA	iShares Core MSCI EAFE ETF	$530,658,618	8,004,183
IEMG	iShares Core MSCI Emerging Markets ETF	$553,682,087	11,306,758
IWM	iShares Russell 2000 ETF	$6,202,712,384	33,896,457
IYR	iShares U.S. Real Estate ETF	$574,764,729	6,905,724
JNK	SPDR Bloomberg High Yield Bond ETF	$761,813,968	8,366,332
KRE	SPDR S&P Regional Banking ETF	$730,171,702	16,549,123
KWEB	KraneShares CSI China Internet ETF	$540,782,914	19,393,082
LQD	Shares iBoxx $ Investment Grade Corporate Bond ETF	$2,261,500,682	21,569,358
QQQ	Invesco QQQ Trust	$18,595,359,899	50,027,506
RSP	Invesco S&P 500 Equal Weight ETF	$852,555,992	5,795,082

SMH	VanEck Semiconductor ETF	$1,158,968,787	7,603,553
SOXL	Direxion Daily Semiconductor Bull 3x Shares	$1,356,546,736	61,542,137
SOXS	Direxion Daily Semiconductor Bear 3x Shares	$647,424,841	65,816,096
SPXL	Direxion Daily S&P 500 Bull 3X Shares	$841,777,983	9,749,178
SPY	SPDR S&P 500 ETF Trust	$34,971,417,738	79,030,726
SQQQ	ProShares UltraPro Short QQQ ETF	$2,319,281,990	124,445,645
TLT	iShares 20+ Year Treasury Bond ETF	$3,469,546,370	37,328,733
TNA	Direxion Daily Small Cap Bull 3X Shares	$506,756,845	15,750,951
TQQQ	ProShares UltraPro QQQ	$3,928,939,456	98,454,290
XBI	SPDR S&P Biotech ETF	$665,811,366	8,625,070
XLE	Energy Select Sector SPDR Fund	$1,708,817,762	19,948,160
XLF	Financial Select Sector SPDR Fund	$1,403,745,482	41,035,132
XLI	Industrial Select Sector SPDR Fund	$1,016,318,692	9,660,975
XLK	Technology Select Sector SPDR Fund	$1,153,958,503	6,635,138
XLP	Consumer Staples Select Sector SPDR Fund	$853,687,804	11,969,322
XLU	Utilities Select Sector SPDR Fund	$1,026,772,959	16,431,256
XLV	Health Care Select Sector SPDR Fund	$1,198,471,388	9,145,246
XLY	Consumer Discretionary Select Sector SPDR Fund	$862,116,359	5,195,115

The Exchange believes that permitting cash settlement as a contract term for FLEX ETF Options for the ETFs in the above table would broaden the base of investors that use FLEX Equity Options to manage their trading and investment risk, including investors that currently trade in the OTC market for customized options, where settlement restrictions do not apply.

Today, equity options are settled physically at The Options Clearing Corporation ("OCC"), i.e., upon exercise, shares of the underlying security must be assumed or delivered. Physical settlement may possess certain risks with respect to volatility and movement of the underlying security at expiration against which market participants may need to hedge. The Exchange believes cash settlement may be preferable to physical delivery in some circumstances as it does not present the same risk. If an issue with the delivery of the underlying security arises, it may become more expensive (and time consuming) to reverse the delivery because the price of the underlying security would almost certainly have changed. Reversing a cash payment, on the other hand, would not involve any such issue because reversing a cash delivery would simply involve the exchange of cash. Additionally, with physical settlement, market participants that have a need to generate cash would have to sell the underlying security while incurring the costs associated with liquidating their position as well as the risk of an adverse movement in the price of the underlying security.

With respect to position and exercise limits, cash-settled FLEX ETF Options would be subject to the position limits set forth in proposed Options 3A, Section 18. Accordingly, the Exchange proposes to add subparagraph (b)(1)(B) of Options 3A, Section 18, which would provide that a position in FLEX Equity Options where the underlying security is an ETF that is settled in cash pursuant to Options 3A, Section 3(c)(5)(A)(ii) shall be subject to the position limits set forth in Options 9, Section 13, and subject to the exercise limits set forth in Options 9, Section 15. The proposed rule would further state that positions in such cash-settled FLEX Equity Options shall be aggregated with positions in physically settled options on the same underlying ETF for the purpose of calculating the position limits set forth in Options 9, Section

13 and the exercise limits set forth in Options 9, Section 15.[193] The Exchange further proposes to add in subparagraph (b)(1)(A) of Section 18 a cross-reference to subparagraph (b)(1)(B) of Section 18, as subparagraph (b)(1)(B) would also contain provisions about position limits for FLEX Equity Options that would be exceptions to the statement in Options 3A, Section 18(b)(1)(A) that FLEX Equity Options have no position limits. The Exchange also proposes to add in paragraph (c) of Section 18, a cross-reference to proposed subparagraph (b)(1)(B), as the proposed rule adds language regarding aggregation of positions for purposes of position limits, which will be covered by paragraph (c). Given that each of the underlying ETFs that would currently be eligible to have cash-settlement as a contract term have established position and exercise limits applicable to physically settled options, the Exchange believes it is appropriate for the same position and exercise limits to also apply to cash-settled options. Accordingly, of the 39 underlying securities that would currently be eligible to have cash settlement as a FLEX contract term, 27 would have a position limit of 250,000 contracts pursuant to Options 9, Section 13(d)(5).[194] Further, pursuant to Supplementary Material .01 to Options 9, Section 13, six would have a position limit of 500,000 contracts (EWZ, TLT, HYG, XLF, LQD, and GDX); four (EEM, FXI, IWM, and EFA) would have a position limit of 1,000,000 contracts; one (QQQ) would have a position limit of 1,800,000 contracts; and one (SPY) would have a position limit of 3,600,000.[195]

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193 See proposed Options 3A, Section 18(b)(1)(B), which is based on Cboe Rule 8.35(c)(1)(B). The aggregation of position and exercise limits would include all positions on physically settled FLEX and non-FLEX Options on the same underlying ETFs.

194 Options 9, Section 13(d)(5) provides that to be eligible for the 250,000 contract limit, either the most recent six (6) month trading volume of the underlying security must have totalled at least 100 million shares or the most recent six-month trading volume of the underlying security must have totalled at least seventy-five (75) million shares and the underlying security must have at least 300 million shares currently outstanding.

195 These were based on position limits as of March 5, 2024. Position limits are available on at https://www.theocc.com. Position limits for ETFs are always determined in accordance with the Exchange's Rules regarding position limits.

The Exchange understands that cash-settled ETF options are currently traded in the OTC market by a variety of market participants, e.g., hedge funds, proprietary trading firms, and pension funds.[196] These options are not fungible with the exchange listed options. The Exchange believes some of these market participants would prefer to trade comparable instruments on an exchange, where they would be cleared and settled through a regulated clearing agency. The Exchange expects that users of these OTC products would be among the primary users of exchange-traded cash-settled FLEX ETF Options. The Exchange also believes that the trading of cash-settled FLEX ETF Options would allow these same market participants to better manage the risk associated with the volatility of underlying equity positions given the enhanced liquidity that an exchange-traded product would bring.

In the Exchange's view, cash-settled FLEX ETF Options traded on the Exchange would have three important advantages over the contracts that are traded in the OTC market. First, as a result of greater standardization of contract terms, exchange-traded contracts should develop more liquidity. Second, counter-party credit risk would be mitigated by the fact that the contracts are issued and guaranteed by OCC. Finally, the price discovery and dissemination provided by the Exchange and its members would lead to more transparent markets. The Exchange believes that its ability to offer cash-settled FLEX ETF Options would aid it in competing with the OTC market and at the same time expand the universe of products available to interested market participants. The Exchange believes that an exchange-traded alternative may provide a useful risk management and trading vehicle for market participants and their customers. Further, the Exchange believes listing cash-settled FLEX ETF Options would

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[196] As noted above, other options exchanges have received approval to list certain cash-settled FLEX ETF Options. See supra notes 186 and 187.

provide investors with competition on an exchange platform, as other options exchanges have received Commission approval to list the same options.[197]

The Exchange notes that OCC has received approval from the Commission for rule changes that will accommodate the clearance and settlement of cash-settled ETF options.[198] The Exchange has also analyzed its capacity and represents that it and The Options Price Reporting Authority ("OPRA") have the necessary systems capacity to handle the additional traffic associated with the listing of cash-settled FLEX ETF Options. The Exchange believes any additional traffic that would be generated from the introduction of cash-settled FLEX ETF Options would be manageable. The Exchange expects that members will not have a capacity issue as a result of this proposed rule change. The Exchange also does not believe this proposed rule change will cause fragmentation of liquidity. The Exchange will monitor the trading volume associated with the additional options series listed as a result of this proposed rule change and the effect (if any) of these additional series on market fragmentation and on the capacity of the Exchange's automated systems.

The Exchange does not believe that allowing cash settlement as a contract term would render the marketplace for equity options more susceptible to manipulative practices. The Exchange believes that manipulating the settlement price of cash-settled FLEX ETF Options would be difficult based on the size of the market for the underlying ETFs that are the subject of this proposed rule change. The Exchange notes that each underlying ETF in the table above is sufficiently active to alleviate concerns about potential manipulative activity. Further, in the Exchange's view, the vast liquidity in the 39 underlying ETFs that would currently be eligible to

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197 See supra notes 186 and 187.

198 See Securities Exchange Act Release No. 34-94910 (May 13, 2022), 87 FR 30531 (May 19, 2022) (SR-OCC-2022-003).

be traded as cash-settled FLEX options under the proposal ensures a multitude of market participants at any given time. Moreover, given the high level of participation among market participants that enter quotes and/or orders in physically settled options on these ETFs, the Exchange believes it would be very difficult for a single participant to alter the price of the underlying ETF or options overlying such ETF in any significant way without exposing the would-be manipulator to regulatory scrutiny. The Exchange further believes any attempt to manipulate the price of the underlying ETF or options overlying such ETF would also be cost prohibitive. As a result, the Exchange believes there is significant participation among market participants to prevent manipulation of cash-settled FLEX ETF Options.

Still, the Exchange believes it has an adequate surveillance program in place and intends to apply the same program procedures to cash-settled FLEX ETF Options that it applies to the Exchange's other options products.[199] FLEX options products and their respective symbols will be integrated into the Exchange's existing surveillance system architecture and will thus be subject to the relevant surveillance processes, as applicable. The Exchange believes that the existing surveillance procedures at the Exchange are capable of properly identifying unusual and/or illegal trading activity, which procedures the Exchange would utilize to surveil for aberrant trading in cash-settled FLEX ETF Options.

With respect to regulatory scrutiny, the Exchange believes its existing surveillance technologies and procedures adequately address potential concerns regarding possible manipulation of the settlement value at or near the close of the market. The Exchange notes that

199 For example, the regulatory program for the Exchange includes surveillance designed to identify manipulative and other improper options trading, including, spoofing, marking the close, front running, wash sales, etc.

the regulatory program operated by and overseen by ISE[200] includes cross-market surveillance designed to identify manipulative and other improper trading, including spoofing, algorithm gaming, marking the close and open, as well as more general, abusive behavior related to front running, wash sales, and quoting/routing, which may occur on the Exchange or other markets. These cross-market patterns incorporate relevant data from various markets beyond the Exchange and its affiliates and from markets not affiliated with the Exchange. The Exchange represents that, today, its existing trading surveillances are adequate to monitor trading in the underlying ETFs and subsequent trading of options on those securities listed on the Exchange. Further, with the introduction of cash-settled FLEX ETF Options, the Exchange would leverage its existing surveillances to monitor trading in the underlying ETFs and subsequent trading of options on those securities listed on the Exchange with respect to cash-settled FLEX ETF options.[201]

Additionally, for options, the Exchange utilizes an array of patterns that monitor manipulation of options, or manipulation of equity securities (regardless of venue) for the purpose of impacting options prices on the Exchange (i.e., mini-manipulation strategies). That surveillance coverage is initiated once options begin trading on the Exchange. Accordingly, the Exchange believes that the cross-market surveillance performed by the Exchange or FINRA, on behalf of the Exchange, coupled with ISE's own monitoring for violative activity on the Exchange comprise a comprehensive surveillance program that is adequate to monitor for manipulation of the underlying ETF and overlying option. Furthermore, the Exchange believes

200 ISE maintains a regulatory services agreements with Financial Industry Regulatory Authority, Inc. ("FINRA") whereby FINRA provides certain regulatory services to the exchanges, including cross-market surveillance, investigation, and enforcement services.

201 Such surveillance procedures generally focus on detecting securities trading subject to opening price manipulation, closing price manipulation, layering, spoofing or other unlawful activity impacting an underlying security, the option, or both. The Exchange has price movement alerts, unusual market activity and order book alerts active for all trading symbols.

that the existing surveillance procedures at the Exchange are capable of properly identifying unusual and/or illegal trading activity, which the Exchange would utilize to surveil for aberrant trading in cash-settled FLEX ETF Options.

In addition to the surveillance procedures and processes described above, improvements in audit trails (i.e., the Consolidated Audit Trail), recordkeeping practices, and inter-exchange cooperation over the last two decades have greatly increased the Exchange's ability to detect and punish attempted manipulative activities. In addition, the Exchange is a member of the Intermarket Surveillance Group ("ISG").[202] The ISG members work together to coordinate surveillance and investigative information sharing in the stock and options markets. For surveillance purposes, the Exchange would therefore have access to information regarding trading activity in the pertinent underlying securities.

The proposed rule change is designed to allow investors seeking to effect cash-settled FLEX ETF Options with the opportunity for a different method of settling option contracts at expiration if they choose to do so. As noted above, market participants may choose cash settlement because physical settlement possesses certain risks with respect to volatility and movement of the underlying security at expiration that market participants may need to hedge against. The Exchange believes that offering innovative products flows to the benefit of the investing public. A robust and competitive market requires that exchanges respond to members' evolving needs by constantly improving their offerings. Such efforts would be stymied if exchanges were prohibited from offering innovative products for reasons that are generally debated in academic literature. The Exchange believes that introducing cash-settled FLEX ETF

[202] ISG is an industry organization formed in 1983 to coordinate intermarket surveillance among the SROs by cooperatively sharing regulatory information pursuant to a written agreement between the parties. The goal of the ISG's information sharing is to coordinate regulatory efforts to address potential intermarket trading abuses and manipulations.

Options would further broaden the base of investors that use FLEX Equity Options to manage their trading and investment risk, including investors that currently trade in the OTC market for customized options, where settlement restrictions do not apply. The proposed rule change is also designed to encourage market makers to shift liquidity from the OTC market onto the Exchange, which, it believes, would enhance the process of price discovery conducted on the Exchange through increased order flow. The Exchange also believes that this may open up cash-settled FLEX ETF Options to more retail investors. The Exchange does not believe that this proposed rule change raises any unique regulatory concerns because existing safeguards—such as position limits (and the aggregation of cash-settled positions with physically-settled positions), exercise limits (and the aggregation of cash-settled positions with physically-settled positions), and reporting requirements—would continue to apply. The Exchange believes the proposed position and exercise limits may further help mitigate the concerns that the limits are designed to address about the potential for manipulation and market disruption in the options and the underlying securities.[203]

Given the novel characteristics of cash-settled FLEX ETF Options, the Exchange will conduct a review of the trading in cash-settled FLEX ETF Options over an initial five-year period. The Exchange will furnish five reports to the Commission based on this review, the first of which would be provided within 60 days after the first anniversary of the initial listing date of the first cash-settled FLEX ETF Option under the proposed rule and each subsequent annual report to be provided within 60 days after the second, third, fourth and fifth anniversary of such initial listing. At a minimum, each report will provide a comparison between the trading volume of all cash-settled FLEX ETF Options listed under the proposed rule and physically settled

[203] See supra note 193.

options on the same underlying security, the liquidity of the market for such options products and the underlying ETF, and any manipulation concerns arising in connection with the trading of cash-settled FLEX ETF Options under the proposed rule. The Exchange will also provide additional data as requested by the Commission during this five year period. The reports will also discuss any recommendations the Exchange may have for enhancements to the listing standards based on its review. The Exchange believes these reports will allow the Commission and the Exchange to evaluate, among other things, the impact such options have, and any potential adverse effects, on price volatility and the market for the underlying ETFs, the component securities underlying the ETFs, and the options on the same underlying ETFs and make appropriate recommendations, if any, in response to the reports.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,[204] in general, and furthers the objectives of Section 6(b)(5) of the Act.[205] Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)[206] requirements that the rules of an exchange be 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 regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities 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.

[204] 15 U.S.C. 78f(b)

[205] 15 U.S.C. 78f(b)(5).

[206] 15 U.S.C. 78f(b)(5).

The Exchange believes that the adoption of the proposed rules allowing FLEX Options to trade on ISE in the manner specified above is consistent with the goals of the Act to remove impediments to and perfect the mechanism of a free and open market because it will benefit market participants by providing an additional venue for market participants to provide and seek liquidity for FLEX Options. As the Commission noted in its order granting FLEX trading on Cboe and what was then the Pacific Stock Exchange (now NYSE Arca), trading FLEX Options on an exchange is an alternative to trading customized options in OTC markets and carries with it the advantages of exchange markets such as transparency, parameters and procedures for clearance and settlement, and a centralized counterparty clearing agency.[207] Therefore, the Exchange believes the proposed rule change will promote these same benefits for the market as a whole by providing an additional venue for market participants to trade customized FLEX Options. The Exchange believes that providing an additional venue for FLEX Options will be beneficial by increasing competition for order flow and executions.

In general, transactions in FLEX Options will be subject to many of the same rules that currently apply to non-FLEX Options traded on the Exchange. In order to provide investor with the flexibility to designate terms of the options and accommodate the special trading of FLEX Options, however, the Exchange is proposing to add new rules in proposed Options 3A that will apply solely to FLEX Options. As noted above, the proposed rules are largely consistent with Cboe's rules pertaining to electronic FLEX Options, with certain intended differences primarily to align to current System behavior (and especially current auction behavior) to provide increased consistency for Members trading FLEX Options and non-FLEX Options on ISE, each as discussed above and below. Further, the Exchange has omitted certain Cboe rules from the

[207] See Securities Exchange Act Release No. 36841 (February 14, 1996), 61 FR 6666 (February 21, 1996) (SR-CBOE-95-43) (SR-PSE-95-24) (Order Approving the Trading of Flexibly Structured Equity Options by CBOE and PSE).

proposed rules due to differences in scope and operation of FLEX trading at Cboe compared to the proposed scope and operation of FLEX trading on ISE, each as noted above. For example, the Exchange will not include Cboe rule provisions related to floor trading, Asian- or Cliquet-settled FLEX Index Options, or Micro FLEX Index Options as it does not offer these capabilities today. For the same reason, the Exchange will not allow prices in FLEX trading to be expressed as percentages under this proposal.

The Exchange further believes that its proposal is designed to prevent fraudulent and manipulative acts and practices as the Exchange believes that it has an adequate surveillance program in place and intends to apply the same program procedures to FLEX Options that is applied to the Exchange's other options products, as applicable. As described above, FLEX Option products and their respective symbols will be integrated into the Exchange's existing surveillance system architecture and will be subject to the relevant surveillance processes, thereby allowing the Exchange to properly identify disruptive and/or manipulative trading activity.

A. General Provisions (Section 1)

The Exchange believes that proposed Section 1(a) setting forth the applicability of Exchange Rules will make clear that unless otherwise provided in proposed Options 3A, the Exchange's existing rules will continue to apply to FLEX Options, which will provide consistency for Members trading both FLEX Options and non-FLEX Options on ISE.

The Exchange believes that the defined terms proposed in Section 1(b) will provide increased clarity to Members by specifying definitions like "FLEX Option" and "FLEX Order" that are used throughout Options 3A. The Exchange further believes that adding the definition of "FLEX Order" in Options 3, Section 7(z) will add transparency as to which order types would be available on ISE. Lastly, the non-substantive change proposed in Options 3, Section 7(y) will bring clarity and avoid potential confusion for market participants.

B. Hours of Business (Section 2)

The Exchange believes that specifying the trading hours for FLEX Options in proposed Section 2(a) will provide increased clarity that the trading hours for FLEX Options will generally be the same as the trading hours for corresponding non-FLEX Options as set forth in Options 3, Section 1. As noted above, the proposed language is materially identical to Cboe Rule 5.1(b)(3)(A).

C. FLEX Option Classes and Permissible Series (Section 3(a) and (b))

The Exchange believes that the proposed rule text in Sections 3(a) and 3(b) will provide greater transparency around the Exchange's listing standards for FLEX Option classes and FLEX Option series. Proposed Section 3(b)(1), which will prevent FLEX Options and non-FLEX Options with the same terms from trading concurrently by System enforcing this restriction, is consistent with the Act because this restriction will address concerns that FLEX Options would act as a surrogate for the trading of non-FLEX Options. In particular, a non-FLEX Option trading pursuant to Options 3 has different priority rules than a FLEX Option trading pursuant to proposed Options 3A.[208] Allowing an option with the same terms to trade under both rules concurrently would result in inconsistent order handling and could allow the order priority of non-FLEX Orders to be circumvented. Therefore, the Exchange proposes to prevent this situation by permitting FLEX Options transactions only in options with a different term (exercise

[208] For example, the Exchange's order books will be inapplicable to FLEX Orders and thus certain priority provisions in Options 3, Section 10 applicable to non-FLEX Orders will not be applicable to FLEX Orders, such as the enhanced Primary Market Maker priority in Section 10(c)(1)(B), Preferred Market Maker priority in Section 10(c)(1)(C), and entitlement for orders of 5 contracts or fewer in Section 10(c)(1)(D). FLEX Options will instead be subject to the priority provisions in Options 3A, Section 11(b)(3)(A) (electronic FLEX Auctions), Section 12(e) (FLEX PIM), and Section 13(e) (FLEX SOM).

style, expiration date, or exercise price) than a non-FLEX Option on the same underlying security or index that is already listed for trading. As noted above, the proposed language in Section 3(a) and Section 3(b) is materially identical to Cboe Rule 4.20 and Rule 4.21(a), respectively.

D. FLEX Options Terms (Section 3(c))

The Exchange believes that the terms of FLEX Options pursuant to proposed Options 3A, Section 3(c) serve to perfect the mechanism of a free and open market and a national market system because they will permit investors to customize some of the terms of their FLEX Options to implement more precise trading strategies, which may not be possible using non-FLEX Options. These investors may have improved capability to execute strategies to meet their specific investment objectives by using customized FLEX Options. However, only certain terms as specified in proposed Section 3(c) are subject to flexible structuring by the parties to the FLEX Option transactions, and most of such terms have a specified number of alternative configurations. The Exchange believes that these restrictions are reasonable and designed to further the objectives of the Act and to promote just and equitable principles of trade because limiting FLEX Option terms enables the efficient, centralized clearance and settlement and active secondary trading of opened FLEX Options. As noted above, these terms are consistent with Cboe Rule 4.21(b) except the Exchange will not incorporate applicable Cboe provisions relating to Asian- or Cliquet-settled FLEX Options, Micro FLEX Index Options, or relating to prices that are expressed as a percentage value because the Exchange does not offer these features today.

As discussed above, the Exchange is proposing to allow the listing of FLEX PM Third Friday Options on ISE, consistent with the Commission's recent approval of Cboe's proposal to make its pilot a permanent program.[209] The Exchange believes that aligning to Cboe will allow ISE to compete effectively with Cboe's product offering. Like Cboe, the Exchange believes that FLEX PM Third Friday Options will provide investors with greater trading opportunities and flexibility. The Exchange notes that the Commission recently approved proposals to make other pilots permitting p.m.-settlement of index options permanent after finding those pilots were consistent with the Act and the options subject to those pilots had no significant impact on the market.[210]

The Exchange further believes that permitting ISE to list FLEX PM Third Friday Options, similar to Cboe, will remove impediments to and perfect the mechanism of a free and open market and a national market system and protect investors, while maintaining a fair and orderly market. As described in the FLEX Settlement Pilot Approval, Cboe observed no significant adverse market impact or identified any meaningful regulatory concerns during the nearly 14-year operation of the FLEX PM Third Friday Program as a pilot nor during the 15 years since P.M.-settled index options (SPX) were reintroduced to the marketplace.[211]

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209 See supra note 35.

210 See Securities Exchange Act Release Nos. 98454 (September 20, 2023) (SR–CBOE–2023–005) (order approving proposed rule change to make permanent the operation of a program that allows the Exchange to list p.m.-settled third Friday-of-the-month SPX options series) ("SPXPM Approval"); 98455 (September 20, 2023) (SR–CBOE–2023–019) (order approving proposed rule change to make permanent the operation of a program that allows the Exchange to list p.m.-settled third Friday-of-the-month XSP and MRUT options series) ("XSP and MRUT Approval"); and 98456 (September 20, 2023) (SR–CBOE–2023–020) (order approving proposed rule change to make the nonstandard expirations pilot program permanent) ("Nonstandard Approval"). See also Securities Exchange Act Release Nos. 98450 (September 20, 2023), 88 FR 66111 (September 26, 2023) (SR-ISE-2023-08) (order approving proposed rule change to make permanent certain p.m.-settled pilots); and 98935 (November 14, 2023), 88 FR 80792 (November 20, 2023) (SR-ISE-2023-20) (order approving a proposed rule change to permit the listing and trading of p.m.-settled Nasdaq-100 Index® Options with a third-Friday-of-the-month expiration).

211 Notably, Cboe did not identify any significant economic impact (including on pricing or volatility or in connection with reversals) on related futures, the underlying indexes, or the underlying component securities of the underlying indexes surrounding the close as a result of the quantity of FLEX PM Third Friday Options or the amount of expiring open interest in FLEX PM Third Friday Options, nor any demonstrated capacity for options hedging activity to impact volatility in the underlying markets. See supra note 35.

As discussed in the FLEX Settlement Pilot Approval, the DERA staff study and corresponding Cboe study concluded that a significantly larger amount of non-FLEX p.m.-settled index options had no significant adverse market impact and caused no meaningful regulatory concerns. Therefore, the Exchange believes it is reasonable to conclude that the relatively small amount of FLEX Index Option volume would similarly have no significant adverse market impact or cause no meaningful regulatory concerns.[212]

The Exchange also believes the introduction of FLEX PM options had no significant impact on the market quality of corresponding a.m.-settled options or other options. As discussed in the FLEX Settlement Pilot Approval, Cboe's analysis conducted after the introduction of SPXW options with Tuesday and Thursday expirations demonstrated no statistically significant impact on the bid-ask or effective spreads of SPXW options with Monday, Wednesday, and Friday expirations after trading in the SPXW options with Tuesday and Thursday expirations began.[213] Further, Cboe concluded that large FLEX PM Third Friday Options trades had no material negative impact (and likely no impact) on quote quality of non-FLEX a.m.-settled options overlying the same index with similar terms as the FLEX PM Third Friday Option upon evaluating data that showed that the spreads were relatively stable before and after large trades.[214] Therefore, the Exchange believes Cboe's evaluation effectively

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212 See supra note 35. Additionally, these studies measured any impact on related futures, the underlying indexes, or the underlying component securities of the underlying indexes surrounding the close. Despite FLEX SPX options (which represent approximately half of the year-to-date 2023 volume of FLEX Index Options but only approximately 0.3% of total SPX volume) not being included in the DERA staff study and corresponding Cboe study, those studies concluded that during the time periods covered (which included the period of time in which the Pilot Program has been operating), there was no significant economic impact on the underlying index or related products. Therefore, the Exchange believes it is reasonable to conclude that any FLEX SPX Options that executed during the timeframes covered by the studies had no significant impact on the underlying index or related products, as neither DERA staff nor Cboe observed any significant economic impact on the underlying index or related product.

213 See supra note 35.

214 Specifically, Cboe evaluated each FLEX PM Third Friday Options trade for more than 500 contracts that occurred on Cboe during a two-year timeframe and analyzed the market quality (specifically, the average

demonstrates it is likely that FLEX PM Third Friday Options have had no significant negative impact on the market quality of non-FLEX Options with a.m.-settlement.[215]

Additionally, the significant changes in the closing procedures of the primary markets in recent decades, including considerable advances in trading systems and technology, has significantly minimized risks of any potential impact of FLEX PM Third Friday Options on the underlying cash markets. As such, the Exchange believes that this proposal does not raise any unique or prohibitive regulatory concerns and that such trading has not, and will not, adversely impact fair and orderly markets on expiration Fridays for the underlying indexes or their component securities.

E. FLEX Fungibility (Section 3(d))

The Exchange believes that the FLEX fungibility provisions in proposed Options 3A, Section 3(d) are consistent with the Act by preventing new FLEX Option positions from being opened when a non-FLEX Option with the same terms is listed for trading. Pursuant to proposed Section 3(d)(1), a FLEX Option with the same terms as a subsequently added non-FLEX Option would become fungible with the non-FLEX Option. Accordingly, once a non-FLEX Option is added with the same terms as an outstanding FLEX Option, the FLEX Option would effectively become a standardized, non-FLEX Option and trade under the same rules and procedures that apply to any other standard non-FLEX Option. The Exchange believes that enforcing consistent order handling for identical and fungible options prevents fraudulent and manipulative acts and practices, and promotes just and equitable principles of trade to protect investors and the public

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time-weighted quote spread and size 30 minutes prior to the trade and the average time-weighted quote spread and size 30 minutes after the trade) of series non-FLEX a.m.-settled options overlying the same index with similar terms as the FLEX PM Third Friday Option that traded (time to expiration, type (call or put), and strike price) as set forth in the Cboe's data. See supra note 35.

215 The Exchange acknowledges that, while FLEX PM Third Friday Options has historically represented a very small percentage of overall volume, it is possible trading in these options may grow in the future.

interest by ensuring consistent treatment of these options. As noted above, proposed Section 3(d)(1) is materially identical to Cboe Rule 4.22(a).

As noted above, the Exchange will not incorporate language from Cboe Rule 4.22(b) related to closing only transactions for FLEX Option series that become fungible with identical non-FLEX Option series. Pursuant to proposed Options 3A, Section 3(d)(2), the Exchange will not allow intra-day additions of non-FLEX Options in the same series with identical terms as an already-listed FLEX Option series for the remainder of the trading day. In such instances, the non-FLEX Option series could be added overnight to begin trading the the next trading day (upon which all existing open positions in the FLEX Option would become fully fungible with transactions in the identical non-FLEX Option series, and any further trading in the series would be as non-FLEX Options subject to non-FLEX trading procedures and Rules). The Exchange believes its proposal will be a straightforward process that ensures consistent treatment of FLEX Options with identical, fungible non-FLEX Options.

F. Units of Trading; Minimum Trading Increments (Sections 4 and 5)

The Exchange believes that the proposed rule text in Section 4(a) provides clear, transparent language regarding how bids and offers for FLEX Options must be expressed. As noted above, proposed Section 4(a) is consistent with Cboe Rule 5.3(e)(3) except the Exchange is not proposing to provide for Micro FLEX Index Options or to allow prices to be expressed as a percentage value because the Exchange does not offer these features today.

The Exchange similarly believes that proposed Section 5(a) provides clarity to market participants that the Exchange will determine the minimum increments for bids and offers on FLEX Options on a class-by-class basis, which may be no smaller than $0.01. Allowing FLEX Options to trade in increments as small as $0.01 is consistent with the Act because it provides investors with increased ability to meet their specific investment objectives and allows for increased opportunities for price improvement through a finer trading increment. As noted above, proposed Section 5(a) is consistent with Cboe Rule 5.4(c)(4) except the Exchange is not proposing to allow prices to be expressed as a percentage value.

G. Types of Orders; Order and Quote Protocols (Section 6)

The Exchange believes that specifying in proposed Section 6(a) that it may make the order types and times-in-force specified in Options 3, Section 7 available on a class or System basis for FLEX Orders is consistent with the Exchange's existing authority to designate the availability of order types and times-in-force for non-FLEX Orders.[216]

The Exchange further believes proposed Section 6(b) will provide greater transparency as to which existing order and quote protocols would be available for FLEX Orders, FLEX auction notifications, and FLEX auction responses.

H. Complex Orders (Section 7)

The Exchange believes the proposed Section 7 will provide investors with additional transparency regarding order entry requirements for complex FLEX Options. As noted above, the proposed complex FLEX Order entry requirements will be consistent with Cboe Rule 5.70(b), except the Exchange will not offer Asian-settled or Cliquet-settled FLEX Index Options.

The Exchange also believes that allowing the submission of complex FLEX Orders with any ratio will remove impediments to and perfect the mechanism of a free and open market and benefit investors, because it will provide Members with additional flexibility and precision in their investment strategies. As noted above, Cboe already offers this feature for complex FLEX Orders, so the Exchange believes that the proposed changes will promote a free and open market

[216] See introductory paragraph to Options 3, Section 7.

and a national market system by providing an additional venue for market participants to execute complex FLEX Orders with any ratio.[217]

I. Opening of FLEX Trading (Section 8)

The Exchange believes that proposed Section 8, which will specify that there will be no Opening Process in FLEX Options and that Members may begin submitting FLEX Orders into an electronic FLEX Auction, a FLEX PIM, or a FLEX SOM when the underlying security is open for trading, will provide clarity to market participants regarding the mechanisms available for FLEX trading. The Exchange will not conduct an Opening Process in FLEX Options due to the customized nature of these products and the fact that there will be no requirement for specific FLEX Option series to be quoted or traded each day. The Exchange notes that Cboe likewise does not hold an opening trading rotation in FLEX Options.[218]

The Exchange also believes that allowing Member to begin submitting FLEX Orders once the underlying security is open is appropriate. Because market participants incorporate transaction prices of underlying securities or the values of underlying indexes when pricing options (which will include FLEX Options), the Exchange believes it will benefit investors for FLEX Options trading to not be available until that information has begun to be disseminated in the market. Because the Exchange will have no electronic book of resting orders for FLEX Options (and no Opening Process), being "open" for FLEX trading merely means that Members may submit FLEX Orders into one of the specified FLEX auction mechanisms once the underlying is open, at the conclusion of which executions in those auction mechanisms may occur (which are all discussed in the respective FLEX Auction, FLEX PIM, and FLEX SOM sections above).

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[217] See supra note 54.

[218] See Cboe Rule 5.71. See supra note 55.

J. Trading Halts (Section 9)

The Exchange believes that proposed Section 9 will provide clarity as to when the Exchange would halt trading in FLEX Options. The reasons why the Exchange would halt trading in a non-FLEX Option class (e.g., trading in the underlying security is halted) would generally be reasons why the Exchange would halt a FLEX Option class, and therefore the Exchange will always halt trading in a FLEX Option class when trading in a non-FLEX Option class with the same underlying equity security or index is halted on the Exchange. Proposed Section 9 also provides the Exchange with authority to halt trading in a FLEX Option, even if trading in a non-FLEX Option with the same underlying is not halted. While such situation would be rare, there may be unusual circumstances that would cause the Exchange to halt trading in the FLEX Option. As noted above, the proposed halt provisions are consistent with Cboe Rule 4.21(a)(3).

K. Exchange Order Books (Section 10)

The Exchange believes that specifying in proposed Section 10 that the Exchange's simple and complex order books will not be available for transactions in FLEX Options will make clear what mechanisms would be available for FLEX trading (or not). FLEX Orders may only be submitted into a FLEX Auction, FLEX PIM, or FLEX SOM. As noted above, proposed Section 10 is consistent with the FLEX rules of other options exchanges that similarly do not contemplate the interaction of their respective order books with FLEX transactions.[219]

L. FLEX Options Trading (Section 11)

The Exchange believes that proposed Section 11(a), which specifies the requirements for submitting FLEX Orders for trading, is consistent with the Act. Proposed Section 11(a) will set

219 See supra note 60.

forth which mechanisms would be available for FLEX Orders (i.e., electronic FLEX Auction, FLEX PIM, or FLEX SOM) and the order entry requirements for simple and complex FLEX Orders. As noted above, these provisions will be substantially similar to Cboe Rule 5.72(b).[220] The Exchange believes that System-enforcing the stipulation that it will not accept simple or complex FLEX Orders if the order or leg, as applicable, has identical terms as a non-FLEX Option series that is already listed for trading will prevent options with the same terms to trade as both a FLEX Options and non-FLEX Option, thereby eliminating any potential concerns around inconsistent order handling.

The Exchange believes that the electronic FLEX Auction as described in proposed Section 11(b) will remove impediments to and perfect the mechanism of a free and open market, and protect investors and the public interest. The proposed FLEX Auction will offer market participants with an auction mechanism for the execution of FLEX Options at potentially improved prices that is substantially similar in all respects to Cboe Rule 5.72(c), except for certain intended differences to align to current auction functionality in order to allow the proposed FLEX Auction to fit more seamlessly into the Exchange's market. For instance, the Exchange will not allow prices to be expressed as percentages in the electronic FLEX Auction as it does not have this capability today. The Exchange will also follow current non-FLEX auction behavior by allowing the FLEX Auction to end at the market close with an execution (if an execution is permitted pursuant to proposed Section 11(b)) in the event the designated exposure interval exceeds the market close.[221] In doing so, the Exchange's proposal will promote executions in electronic FLEX Auctions while also preventing executions after the market close.

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220 See supra notes 61-64.

221 See proposed Options 3A, Section 11(b)(1)(F). While the current rules are silent in this regard, the Exchange notes that its proposal will follow current SOM and PIM behavior. See generally Options 3, Sections 11(d) and 13.

The Exchange will also align the minimum increment requirements in proposed Section 11(b)(1)(G) for stock-tied FLEX complex strategies with its existing requirements for stock-tied non-FLEX complex strategies in Options 3, Section 14(c)(1). Furthermore, pursuant to proposed Section 11(b)(2)(D), the Exchange would not allow Members to submit multiple FLEX responses using the same badge/mnemonic and would also not aggregate all of those responses at the same price in order to align to current auction functionality for non-FLEX Orders. Additionally, the Exchange will also specify in proposed Section 11(b)(2)(D) that an additional FLEX response from the same badge/mnemonic for the same auction ID will automatically replace the previous FLEX response.[222] The Exchange will also align the proposed FLEX Auction allocation methodology (i.e., Priority Customer Size Pro-Rata and one contract allocation)[223] and related rounding (i.e., rounding up for the higher response quantity)[224] with current auction functionality in those respects.[225] The Exchange believes that the proposed priority and allocation rules for the FLEX Auction will ensure a fair and orderly market by maintaining the priority of orders and protecting Priority Customer orders, while still affording the opportunity for price improvement during each FLEX Auction commenced on the Exchange. As noted above, all of the foregoing features are harmonized with the Exchange's current auction functionality for non-FLEX Orders, including PIM and SOM, so the Exchange believes that this will promote consistency for Members participating across different auctions on ISE.

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222 While this behavior is not specified in the Exchange's current rules, auction responses are currently handled in the same manner for SOM and PIM. See generally Options 3, Sections 11(d)(2) and 13(c).

223 See proposed Options 3A, Sections 11(b)(3)(A)(i) and (iii).

224 See proposed Options 3A, Sections 11(b)(3)(A)(ii).

225 See, e.g., Options 3, Section 11(d)(3)(C) (SOM allocation methodology); Options 3, Section 13(d) (PIM allocation methodology); Supplementary Material .09 to Options 3, Section 11; and Supplementary Material .10 to Options 3, Section 13.

Furthermore, unlike Cboe, the Exchange will not include certain details in the proposed FLEX Auction notification message in proposed Section 11(b)(2)(A) like what time the auction will conclude or whether the FLEX Order is Attributable. For simplicity, the Exchange will instead disseminate the duration of the exposure interval, instead of calculating and disseminating what time the auction will conclude, and will not offer an Attributable designation for FLEX Orders.

Otherwise, the general framework of the proposed electronic FLEX Auction in Section 11(b) (such as the eligibility requirements, the auction process and conclusion, and execution provisions) is consistent with the framework for Cboe's electronic FLEX Auctions in Cboe Rule 5.72(c). The clarity in how the proposed FLEX Auction will function and its consistency with similar auctions at another exchange will help promote a fair and orderly national options market system.

Like Cboe, the Exchange believes that the proposed auction exposure interval periods strike an appropriate balance between allowing executions of FLEX Orders to be completed in a timely fashion and providing Members sufficient time to price the unique terms of FLEX Options. As noted above, the submitting Member must designate the length of the exposure interval (which will be included in the auction notification message) to be between three seconds and five minutes, which is identical to Cboe's range of exposure intervals for their electronic FLEX Auctions in Cboe Rule 5.72(c)(1)(F). The Exchange believes it is appropriate to require the submitting Member to establish the length of the auction period (which will be included in the auction notification message), as the Member is in the best position to determine a reasonable period of time to provide other Members to respond based on the complexity of the FLEX Option series that is the subject of the auction, as well as based on market conditions (for example, in a volatile market, the Member may believe it is in the best interests of a customer to have a shorter auction period given quickly changing prices).

The Exchange believes that the proposed rule change to allow multiple electronic FLEX Auctions overlap will benefit investors, as it may lead to an increase in Exchange volume and permit the Exchange to compete with the OTC market, while providing for additional opportunities for price discovery and execution. Although electronic FLEX Auctions will be allowed to overlap, the Exchange does not believe that this raises any issues that are not addressed through the proposal as described above. For example, although overlapping, each auction will be started in a sequence and with a time that will determine its processing. Thus, even if there are two auctions that commence and conclude, at nearly the same time, each auction will have a distinct conclusion at which time the auction will be allocated. Additionally, FLEX Orders submitted into an electronic FLEX Auction will be able to execute only against FLEX responses submitted to that auction. If market participants desire to have interest execute against both FLEX Orders subject to concurrent FLEX Auctions, market participants may submit responses to both auctions. Additionally, the proposed concurrent auction feature is materially identical to Cboe's electronic FLEX Auction feature in Cboe Rule 5.72(c)(2)(B).

M. FLEX PIM and FLEX SOM (Sections 12 and 13)

The Exchange believes that the FLEX PIM and FLEX SOM Auctions as described in proposed Sections 12 and 13, respectively, will remove impediments to and perfect the mechanism of a free and open market, and protect investors and the public interest. The proposed FLEX PIM and FLEX SOM Auctions will offer market participants with auction mechanisms for the execution of FLEX Options at potentially improved prices that are substantially similar to Cboe's FLEX AIM and FLEX SAM set forth in Cboe Rule 5.73 and

5.74, respectively, except for certain intended differences to align to the Exchange's current PIM and SOM auction functionality to allow the proposed FLEX PIM and SOM Auctions to fit more seamlessly into the Exchange's market. For instance, the Exchange will not allow prices to be expressed as percentages in FLEX PIM or FLEX SOM as it does not have this capability today. For FLEX SOM, the Exchange will not allow the Solicited Order to be comprised of multiple solicited orders in FLEX SOM to be consistent with current non-FLEX SOM functionality in Options 3, Section 11(d). The Exchange will also align the minimum increment requirements for stock-tied FLEX complex strategies submitted into FLEX PIM or FLEX SOM with its existing requirements for stock-tied non-FLEX complex strategies in Options 3, Section 14(c)(1). The Exchange will also follow current non-FLEX PIM and SOM behavior by allowing the FLEX PIM or FLEX SOM Auction to end at the market close with an execution (if an execution is permitted pursuant to proposed Section 12 or Section 13, as applicable) in the event the designated length of the auction period exceeds the market close.[226] In doing so, the Exchange's proposal will promote executions in FLEX PIM and FLEX SOM while also preventing executions after the market close. Furthermore, pursuant to Sections 12(c)(5)(B) and 13(c)(5)(B) (as applicable), the Exchange would not allow Members to submit multiple FLEX PIM or FLEX SOM responses using the same badge/mnemonic and would also not aggregate all of those responses at the same price in order to align to current PIM and SOM functionality for non-FLEX Orders. Additionally, the Exchange will also specify that an additional FLEX PIM or SOM response from the same badge/mnemonic for the same auction ID will automatically

[226] See proposed Options 3A, Sections 12(c)(3) and 13(c)(3). While the current rules are silent in this regard, the Exchange notes that its proposal will follow current SOM and PIM behavior. See generally Options 3, Sections 11(d) and 13.

replace the previous FLEX PIM or SOM response.[227] The Exchange will also align to current PIM functionality by allowing a limited exception to the restriction in proposed Section 12(c)(4) against modifying or canceling a FLEX PIM Agency Order or Initiating Order by allowing Initiating Members to improve the price of their Initiating Orders.[228] The Exchange will also align to current SOM functionality by allowing Initiating Members to cancel (but not modify) their FLEX SOM Agency Orders and Solicited Orders pursuant to proposed Section 13(c)(4).[229]

The Exchange will also align certain aspects of the proposed FLEX PIM allocation methodology with its current non-FLEX PIM allocation methodology. First, the Exchange will base the allocation percentages set forth in proposed Section 12(e)(1)(B)(ii) on the original size of the Agency Order, instead of the number of contract remaining after execution against Priority Customer responses like Cboe Rule 5.73(e)(1)(B)(ii). As noted above, this will align to current PIM behavior in Options 3, Section 13(d)(3). Second, the Exchange will specify two limited scenarios in proposed Section 12(e)(1)(B) where the Initiating Member could receive an allocation percentage that is greater than the Initiating Member's guaranteed allocation (i.e., when there are remaining contracts after including all PIM responses or when rounding up). As noted above, while Cboe does not have these exceptions noted in Cboe Rule 5.73(e)(1)(B), this will be consistent with current PIM behavior.[230] Third, the Exchange will specify in proposed Section 12(e)(2)(B) that other FLEX PIM responses at prices better than the final auction price will be allocated in time priority and all other FLEX PIM responses at the final auction price will

[227] While this behavior is not specified in the Exchange's current rules, auction responses are currently handled in the same manner for SOM and PIM. See generally Options 3, Sections 11(d)(2) and 13(c).

[228] See supra note 102 and accompanying text.

[229] As noted above, while this feature is not explicitly stated in the current SOM rules in Options 3, Section 13(d), it is consistent with current SOM functionality.

[230] See supra note 114.

be allocated on a Size Pro-Rata Basis.[231] Fourth, the Exchange will replace Cboe's last priority allocation in Cboe Rule 5.73(e)(4) with a guaranteed allocation feature in proposed Section 12(e)(4), which will be similar to a current PIM feature currently in Options 3, Section 13(d)(3) that allows Members to request a lower percentage than their guaranteed allocation.[232] For both FLEX PIM and FLEX SOM, the Exchange will also specify that if an allocation would result in less than one contract, then one contract will be allocated.[233] This would align to current SOM and PIM allocation.[234] As noted above, all of the foregoing features are consistent with the Exchange's current PIM and SOM auction functionality for non-FLEX Orders, so the Exchange believes that this will promote consistency for Members participating across different auctions on ISE.

Otherwise, the general frameworks of the proposed FLEX PIM and FLEX SOM Auctions in Sections 12 and 13 (such as the eligibility requirements, stop price requirements, auction process and conclusion, and execution provisions) are consistent with the frameworks for Cboe's FLEX AIM and FLEX SAM in Cboe Rules 5.73 and 5.74, respectively. The clarity in how FLEX PIM and FLEX SOM will function and their consistency with similar auctions at another exchange will help promote a fair and orderly national options market system. For example, the proposed range for the length of each of the FLEX PIM and FLEX SOM Auction periods is consistent with the range for the auction periods of the Cboe's FLEX AIM and FLEX SAM Auctions in Cboe Rules 5.73(c)(3) and 5.74(c)(3), respectively. Like Cboe, the Exchange believes it is appropriate to provide a reasonable and sufficient amount of time in which market

231 See supra note 118.

232 See supra note 121.

233 See proposed Supplementary Material .03 to Options 3A, Section 11 and Supplementary Material .03 to Options 3A, Section 12.

234 See Supplementary Material .09 to Options 3, Section 11 and Supplementary Material .10 to Options 3, Section 13).

participants may submit responses because of the unique terms of FLEX Options. Therefore, the Exchange is proposing that the minimum length of a FLEX PIM or FLEX SOM Auction be three seconds. The Exchange also proposes a maximum length of an auction period to be five minutes, as the Exchange also believes it is appropriate to provide for efficient and timely executions so that customers do not potentially miss a market. The proposed rule change also requires the Initiating Member to establish the length of the auction period (which will be included in the auction notification message), as the Member is in the best position to determine a reasonable period of time to provide other Members to respond based on the complexity of the FLEX Option series that is the subject of the auction, as well as based on market conditions (for example, in a volatile market, the Member may believe it is in the best interests of a customer to have a shorter auction period given quickly changing prices).

The proposal will also allow FLEX PIM and FLEX SOM Auctions to occur concurrently with other FLEX PIM and FLEX SOM Auctions. As discussed above, the Exchange is aligning with current Cboe FLEX AIM and FLEX SAM behavior in Cboe Rules 5.73(c)(1) and 5.74(c)(1), respectively. Like Cboe, the Exchange does not believe that allowing FLEX PIM and FLEX SOM Auctions to overlap would raise any issues that are not addressed by proposal. For example, although overlapping, each FLEX PIM or FLEX SOM Auction will be started in a sequence and with a duration that determines its processing. Thus, even if there are two FLEX PIM or FLEX SOM Auctions that commence and conclude, at nearly the same time, each Auction will have a distinct conclusion at which time the Auction will be allocated, and only against responses submitted into that Auction. As discussed above, each FLEX PIM or FLEX SOM response is required to specifically identify the FLEX PIM or FLEX SOM Auction, respectively, for which it is targeted and if not fully executed, will be cancelled back at the conclusion of the Auction. Thus, responses will be specifically considered and executed only in the specified Auction. As a general matter, issues with concurrent auctions can relate to the interaction of auctioned orders with contra-side interest resting on the book at the end of various auctions. As noted above, there will be no order book available for FLEX trading, so there can be no conflict among contra-side interest resting on the book and FLEX PIM or FLEX SOM responses with respect to executions. Further, because there is no book for FLEX Options, there are no events that cause a FLEX PIM or FLEX SOM to conclude prior to the end of auction exposure period that would result in an execution, and therefore, the same event could not cause multiple auctions to conclude early.

Like Cboe, the Exchange will apply a Size Pro-Rata execution algorithm with a Priority Customer overlay for FLEX PIM and FLEX SOM.[235] The Exchange believes that the proposed priority and allocation rules for FLEX PIM and FLEX SOM will ensure a fair and orderly market by maintaining the priority of orders and protecting Priority Customer orders, while still affording the opportunity for price improvement during each FLEX PIM and FLEX SOM Auction commenced on the Exchange.

N. Risk Protections (Section 14)

The Exchange believes that specifying the risk protections in proposed Options 3A, Section 14 will benefit investors with additional transparency regarding which of the Exchange's risk protections in Options 3, Sections 15 (simple order risk protections, 16 (complex order risk protections), and 28 (optional risk protections) would apply to FLEX trading. The Exchange also believes that applying the foregoing risk protections to FLEX Options will protect investors and the public interest, and maintain fair and orderly markets, by providing market participants

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235 See proposed Options 3A, Sections 12(e) and 13(e). As noted above, this is also consistent with the Exchange's current priority and allocation methodology for non-FLEX auctions, including SOM and PIM. See Options 3, Section 11(d)(3)(C) and Section 13(d).

with more tools to manage their risk. In addition, providing Members with more tools for managing risk facilitates transactions in FLEX Options because Members will have more confidence that risk protections are in place. As a result, apply the foregoing risk protections has the potential to promote just and equitable principles of trade.

O. Data Feeds (Section 15)

The Exchange believes that specifying the data feeds in proposed Options 3A, Section 15 will benefit investors with additional transparency regarding which data fees it will disseminate auction notifications for simple and complex FLEX Orders. As discussed above, the Exchange proposes to disseminate auction notifications for simple FLEX Orders through the Order Feed and auction notifications for complex FLEX Orders through the Spread Feed, which will be consistent with how non-FLEX simple and complex auction notifications are disseminated today.

P. FLEX Market Makers and Letters of Guarantee (Sections 16 and 17)

The Exchange believes that the proposed FLEX Market Maker provisions in Section 16 will provide clarity and transparency as to how FLEX Market Makers are appointed and their related obligations. As noted above, these provisions are substantially similar to other options exchanges, notably Cboe and Phlx.[236]

Pursuant to proposed Section 17, the Exchange's current Letter of Guarantee will effectively apply to FLEX transactions executed on ISE.[237]. The Exchange believes that the existing Letter of Guarantee continues to protect investors and the public interest because it signifies that the clearing member has accepted financial responsibility for transactions in all

[236] See supra notes 160 - 162.

[237] Today, all ISE Market Makers are required to enter into a Letter of Guarantee pursuant to Options 6, Section 4. This letter will automatically extend to FLEX transactions. Cboe Rule 3.61(e) separately requires FLEX Market Makers to provide a Letter of Guarantee issued by a clearing member and filed with the Exchange accepting responsibility for all FLEX transactions made by the FLEX Market Maker.

options entered into by the Market Maker, which will protect the counterparties of those trades and such protections will flow to other clearing members and ultimately to the OCC as the central counterparty and guarantor of both FLEX and non-FLEX Option transactions.

Q. Position and Exercise Limits (Sections 18 and 19)

Position and exercise limits are designed to address potential manipulative schemes and adverse market impacts surrounding the use of options, such as disrupting the market in the security underlying the options. While position and exercise limits should address and discourage the potential for manipulative schemes and adverse market impact, if such limits are set too low, participation in the options market may be discouraged. The Exchange believes that any decision regarding imposing position and exercise limits for FLEX Options must therefore be balanced between mitigating concerns of any potential manipulation and the cost of inhibiting potential hedging activity that could be used for legitimate economic purposes.

As it relates to FLEX Index Options, the Exchange believes that the proposed position and exercise limits in Sections 18(a), 18(c), and 19(a) are reasonably designed to prevent a Member from using FLEX Index Options to evade the position limits applicable to comparable non-FLEX Index Options. Further, by establishing the proposed position and exercise limits for FLEX Index Options and, importantly, aggregating such positions in the manner described in proposed Sections 18(c)(1), (c)(2), and 19(a)(3), the Exchange believes that the position and exercise limit requirements for FLEX Index Options should help to ensure that the trading of FLEX Index Options would not increase the potential for manipulation or market disruption and could help to minimize such incentives. The Exchange also notes that proposed position and exercise limits are consistent with the rules of other options exchanges that offer FLEX Index Options, and therefore raise no novel issues for the Commission.[238]

As it relates to FLEX Equity Options, while no position limits are proposed for FLEX Equity Options, there are several mitigating factors, which include aggregation of FLEX Equity Option and non-FLEX Equity Option positions that expire on a third Friday-of-the-month and subjecting those positions to position and exercise limits, and daily monitoring of market activity. Similar to the other exchanges that trade FLEX Equity Options, the Exchange believes that eliminating position and exercise limits for FLEX Equity Options, while requiring positions in FLEX Equity Options that expire on a third Friday-of-the-month to be aggregated with positions in non-FLEX Equity Options on the same underlying security,[239] removes impediments to and perfects the mechanism of a free and open market and a national market system because it allow the Exchange to create a product and market that is an improved but comparable alternative to the OTC market in customized options. OTC transactions occur through bilateral agreements, the terms of which are not publicly disclosed to the marketplace. As such, OTC transactions do not contribute to the price discovery process that exists on a public exchange.

The Exchange believes that the proposed elimination of position and exercise limits for FLEX Equity Options may encourage market participants to transfer their liquidity demands from OTC markets to exchanges and enable liquidity providers to provide additional liquidity to ISE through transactions in FLEX Equity Options. The Exchange notes that the Commission previously approved the elimination of position and exercise limits for FLEX Equity Options, finding that such elimination would allow exchanges "to better compete with the growing OTC

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[238] See Phlx Options 8, Section 34(e) and Cboe Rules 8.35(a), (d), and 8.42(g).

[239] See proposed Options 3A, Section 18(c)(3) and Section 19(a)(3). See also Cboe Rules 8.35(d)(3) and 8.42(g)(3); NYSE Arca Rules 5.35-O(a)(iii), (b) and 5.36-O; NYSE American Rules 906G and 907G; and Phlx Options 8, Section 34(e) and (f).

market in customized equity options, thereby encouraging fair competition among brokers and dealers and exchange markets."[240] The Commission has also stated that the elimination of position and exercise limits for FLEX Equity Options "could potentially expand the depth and liquidity of the FLEX equity market without significantly increasing concerns regarding intermarket manipulations or disruptions of the options or the underlying securities."[241]

Additionally, the Exchange believes that requiring positions in FLEX Equity Options that expire on a third Friday-of-the-month to be aggregated with positions in non-FLEX Equity Options on the same underlying security subjects FLEX Equity Options and non-FLEX Equity Options to the same position and exercise limits on third Friday-of-the-month expirations. These limitations are intended to serve as a safeguard against potential adverse effects of large FLEX Equity Option positions expiring on the same day as non-FLEX Equity Option positions. As noted above, Cboe Rules 8.35(d)(3) and 8.42(g)(3) have the same requirements.

The Exchange believes that any potential risk of manipulative activity is mitigated by existing surveillance technologies, procedures, and reporting requirements at the Exchange, which allows the Exchange to properly identify disruptive and/or manipulative trading activity. In addition to its own surveillance programs, the Exchange also works with other SROs and exchanges on intermarket surveillance related issues. Through its participation in ISG, the Exchange shares information and coordinates inquiries and investigations with other exchanges designed to address potential intermarket manipulation and trading abuses. The Exchange also notes that FINRA conducts cross-market surveillances on behalf of the Exchange pursuant to a

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240 See Securities Exchange Act Release No. 42223 (December 10, 1999), 64 FR 71158, 71159 (December 20, 1999) (SR-Amex-99-40) (SR-PCX-99-41) (SR-CBOE-99-59) (Order Granting Accelerated Approval to Proposed Rule Change Relating to the Permanent Approval of the Elimination of Position and Exercise Limits for FLEX Equity Options).

241 See id.

regulatory services agreement.[242] The Exchange also represents that it is reviewing its procedures to detect potential manipulation in light of any changes required for FLEX Options to confirm appropriate surveillance coverage. These procedures utilize daily monitoring of market activity via automated surveillance techniques to identify unusual activity in both options and their underlying securities and are designed to protect investors and the public interest by ensuring that the Exchange has an adequate surveillance program in place.

The Exchange believes that proposed Section 18(b)(2) and (3) further mitigates concerns for potential market manipulation and/or disruption in the underlying markets and thus protects investors and the public interest because position reporting will be required (other than for a Market Maker) and the Exchange may determine that a higher margin requirement is necessary in light of the risks associated with a FLEX Equity Option position in excess of the standard limit for non-FLEX Equity Options of the same class. The Exchange may, pursuant to its authority under Options 6C, Section 5, impose additional margin upon the account maintaining such under-hedged position as a safeguard against potential adverse effects of large FLEX Equity Option positions. The Exchange notes that the clearing firm carrying the account will be subject to capital charges under SEC Rule 15c3-1 to the extent of any margin deficiency resulting from a higher margin requirement imposed by the Exchange.

Lastly, the Exchange notes that other exchanges currently trading FLEX options have similar position and exercise limits described above.[243]

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242 The Exchange notes that it is responsible for FINRA's performance under this regulatory services agreement.

243 See Cboe Rules 8.35(d) and 8.42(g); and Phlx Options 8, Section 34(e) and (f).

R. Cash-Settled FLEX ETF Options

Introducing cash-settled FLEX ETF Options will increase order flow to the Exchange, increase the variety of options products available for trading, and provide a valuable tool for investors to manage risk.

The Exchange believes that the proposal to permit cash settlement as a contract term for options on the specified group of equity securities would remove impediments to and perfect the mechanism of a free and open market as cash-settled FLEX ETF Options would enable market participants to receive cash in lieu of shares of the underlying security, which would, in turn provide greater opportunities for market participants to manage risk through the use of a cash-settled product to the benefit of investors and the public interest. The Exchange does not believe that allowing cash settlement as a contract term for options on the specified group of equity securities would render the marketplace for equity options more susceptible to manipulative practices. As illustrated in the table above, each of the qualifying underlying securities is actively traded and highly liquid and thus would not be susceptible to manipulation because, over a six-month period, each security had an average daily notional value of at least $500 million and an ADV of at least 4,680,000 shares, which indicates that there is substantial liquidity present in the trading of these securities, and that there is significant depth and breadth of market participants providing liquidity and of investor interest. The Exchange believes the proposed bi-annual review to determine eligibility for an underlying ETF to have cash settlement as a contract term would remove impediments to and perfect the mechanism of a free and open market as it would permit the Exchange to select only those underlying ETFs that are actively traded and have robust liquidity as each qualifying ETF would be required to meet the average daily notional value and average daily volume requirements, as well as to select the same underlying ETFs on which other exchanges may list cash-settled FLEX ETF Options.[244]

The Exchange believes the proposed change that, for FLEX ETF Options, at least one of exercise style, expiration date, and exercise price must differ from options in the non-FLEX market will provide clarity and eliminate confusion regarding permissible terms of FLEX ETF Options, including the proposed cash-settled FLEX ETF Options.

The Exchange believes that the data provided by the Exchange supports the supposition that permitting cash settlement as a FLEX term for the 39 underlying ETFs that would currently qualify to have cash settlement as a contract term would broaden the base of investors that use FLEX Equity Options to manage their trading and investment risk, including investors that currently trade in the OTC market for customized options, where settlement restrictions do not apply.

The Exchange believes that the proposal to permit cash settlement for certain FLEX ETF options would remove impediments to and perfect the mechanism of a free and open market because the proposed rule change would provide members and member organizations with enhanced methods to manage risk by receiving cash if they choose to do so instead of the underlying security. In addition, this proposal would promote just and equitable principles of trade and protect investors and the general public because cash settlement would provide investors with an additional tool to manage their risk. Further, the Exchange notes that another exchange has previously received approval that allows for the trading of cash-settled options, and, specifically, cash-settled FLEX ETF Options in an identical manner as the Exchange

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[244] See supra notes 186 and 187.

proposes to list them pursuant to this rule filing.[245] The proposed rule change therefore should not raise issues for the Commission that it has not previously addressed.

The proposed rule change to permit cash settlement as a contract term for options on up to 50 ETFs is designed to promote just and equitable principles of trade in that the availability of cash settlement as a contract term would give market participants an alternative to trading similar products in the OTC market. By trading a product in an exchange-traded environment (that is currently traded in the OTC market), the Exchange would be able to compete more effectively with the OTC market. The Exchange believes the proposed rule change is designed to prevent fraudulent and manipulative acts and practices in that it would lead to the migration of options currently trading in the OTC market to trading on the Exchange. Also, any migration to the Exchange from the OTC market would result in increased market transparency. Additionally, the Exchange believes the proposed rule change is designed to remove impediments to and to perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest in that it should create greater trading and hedging opportunities and flexibility. The proposed rule change should also result in enhanced efficiency in initiating and closing out positions and heightened contra-party creditworthiness due to the role of OCC as issuer and guarantor of the proposed cash-settled options. Further, the proposed rule change would result in increased competition by permitting the Exchange to offer products that are currently available for trading only in the OTC market and are approved to trade on another options exchange.

The Exchange believes that establishing position limits for cash-settled FLEX ETF Options to be the same as physically settled options on the same underlying security, and

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[245] See supra notes 186 and 187.

aggregating positions in cash-settled FLEX ETF Options with physically settled options on the same underlying security for purposes of calculating position limits is reasonable and consistent with the Act. By establishing the same position limits for cash-settled FLEX ETF Options as for physically settled options on the same underlying security and, importantly, aggregating such positions, the Exchange believes that the position limit requirements for cash-settled FLEX ETF Options should help to ensure that the trading of cash-settled FLEX ETF Options would not increase the potential for manipulation or market disruption and could help to minimize such incentives. For the same reasons, the Exchange believes the proposed exercise limits are reasonable and consistent with the Act.

Finally, the Exchange represents that it has an adequate surveillance program in place to detect manipulative trading in cash-settled FLEX ETF Options and the underlying ETFs. Regarding the proposed cash settlement, the Exchange would use the same surveillance procedures currently utilized for the Exchange's other FLEX Options. For surveillance purposes, the Exchange would have access to information regarding trading activity in the pertinent underlying ETFs. The Exchange believes that limiting cash settlement to no more than 50 underlying ETFs (currently, 39 ETFs would be eligible to have cash-settlement as a contract term) would minimize the possibility of manipulation due to the robust liquidity in both the equities and options markets.

As a self-regulatory organization, the Exchange recognizes the importance of surveillance, among other things, to detect and deter fraudulent and manipulative trading activity as well as other violations of Exchange rules and the federal securities laws. As discussed above, ISE has adequate surveillance procedures in place to monitor trading in cash-settled FLEX ETF Options and the underlying securities, including to detect manipulative trading activity in both the options and the underlying ETF.[246] The Exchange further notes the liquidity and active markets in the underlying ETFs, and the high number of market participants in both the underlying ETFs and existing options on the ETFs, helps to minimize the possibility of manipulation. The Exchange further notes that under Section 19(g) of the Act, the Exchange, as a self-regulatory organization, is required to enforce compliance by its members and persons associated with its members with the Act, the rules and regulations thereunder, and the rules of the Exchange.[247] The Exchange believes its surveillance, along with the liquidity criteria and position and exercise limits requirements, are reasonably designed to mitigate manipulation and market disruption concerns and will permit it to enforce compliance with the proposed rules and other Exchange rules in accordance with Section 19(g) of the Act. The Exchange performs ongoing evaluations of its surveillance program to ensure its continued effectiveness and will continue to review its surveillance procedures on an ongoing basis and make any necessary enhancements and/or modifications that may be needed for the cash settlement of FLEX ETF Options.

Additionally, the Exchange will monitor any effect additional options series listed under the proposed rule change will have on market fragmentation and the capacity of the Exchange's automated systems. The Exchange will take prompt action, including timely communication with the Commission and with other self-regulatory organizations responsible for oversight of trading in options, the underlying ETFs, and the ETFs' component securities, should any unanticipated adverse market effects develop.

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246 Among other things, ISE's regulatory program include cross-market surveillance designed to identify manipulative and other improper trading, including spoofing, algorithm gaming, marking the close and open, as well as more general abusive behavior related to front running, wash sales, and quoting/routing, which may occur on the Exchange and other markets. Furthermore, the Exchange stated that it has access to information regarding trading activity in the pertinent underlying securities as a member of ISG.

247 15 U.S.C. 78s(g).

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 that is not necessary or appropriate in furtherance of the purposes of the Act.

The Exchange does not believe that the proposed rule change will impose any burden on intra-market competition that is not necessary or appropriate in furtherance of the purposes of the Act, as all Members who wish to trade FLEX Options will be able to trade such options in the same manner. Additionally, positions in FLEX Options of all Members will be subject to the same position limits, and such positions will be aggregated in the same manner as described in proposed Section 18(c).

The Exchange also does not believe that the proposed rule change will impose any burden on inter-market competition that is not necessary or appropriate in furtherance of the purposes of the Act. As discussed above, other options exchanges currently offer electronic FLEX trading and cash-settled FLEX ETF Options on their respective markets. The Exchange believes that its proposal will allow ISE to compete with these other exchanges and provide an additional execution venue for these transactions for market participants. Thus, the Exchange believes that its proposal will promote inter-market competition by increasing the number of exchanges where electronic FLEX trading and cash-settled FLEX ETF Options will be available. The proposal also promotes inter-market competition by providing another alternative (i.e., exchange markets) to bilateral OTC trading of options with flexible terms. Exchange markets, in contrast with bilateral OTC trading, are centralized, transparent, and have the guarantee of OCC for options traded.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were either solicited or received.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission shall: (a) by order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be 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 (https://www.sec.gov/rules/sro.shtml); or
- Send an email to rule-comments@sec.gov. Please include file number SR-ISE-2024-12 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-2024-12. 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 (https://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 a.m. and 3 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. Do not include personal identifiable information in submissions; you should submit only information that you wish to make available publicly. We may redact in part or withhold entirely from publication submitted material that is obscene or subject to copyright protection. All submissions should refer to file number SR-ISE-2024-12 and should be submitted on or before [INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[248]

Sherry R. Haywood,

Assistant Secretary.

248 17 CFR 200.30-3(a)(12).