

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-91223; File No. SR-ISE-2021-01)

February 26, 2021

Self-Regulatory Organizations; Nasdaq ISE, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend Various Rules in Options 3 and Options 5

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on February 18, 2021, 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 amend various rules in Options 3 and Options 5.

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

<sup>2</sup> 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 purpose of the proposed rule change is to amend various rules in Options 3 and Options 5. The proposed changes consist of conforming existing rules to current System technology, amending rule text to add greater detail on how certain Exchange functionality operate today, and conforming language within the Exchange’s rules to the rules of other exchanges. As such, no System changes to existing functionality are being made pursuant to this proposal. Rather, this proposal is designed to reduce any potential investor confusion as to the features and applicability of certain functionality presently available on the Exchange. These changes are described in detail below, and include amending Exchange rules governing: (1) the Block Order Mechanism (“Block”),<sup>3</sup> (2) the Facilitation Mechanism (“Facilitation”),<sup>4</sup> (3) the Solicited Order Mechanism (“Solicitation”),<sup>5</sup> (4) the Price Improvement Mechanism (“PIM”),<sup>6</sup> (5) Trade Value Allowance (“TVA”),<sup>7</sup> (6) Anti-Internalization,<sup>8</sup> and (7) the exposure mechanism (“Exposure”).<sup>9</sup>

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<sup>3</sup> See Options 3, Section 11(a).

<sup>4</sup> See Options 3, Section 11(b).

<sup>5</sup> See Options 3, Section 11(d).

<sup>6</sup> See Options 3, Section 13.

<sup>7</sup> See Supplementary Material .03 to Options 3, Section 14.

<sup>8</sup> See Options 3, Section 15(a)(3)(A).

<sup>9</sup> See Supplementary Material .02 to Options 5, Section 2.

## Universal Changes

In September 2019, the Exchange amended its regular allocation rule in Options 7, Section 10 (Priority of Quotes and Orders) to make non-substantive changes, among other changes, to replace references to Professional interest with non-Priority Customer interest.<sup>10</sup> The Exchange now proposes to make similar changes to replace all instances of “Professional” interest with “non-Priority Customer” interest throughout its auction allocation rules in Options 3, Section 11 and Section 13 to align with the changes made in SR-ISE-2019-21.<sup>11</sup> While the term “Professional Orders” is defined within Options 1, Section 1(a)(39) as an order that is for the account of a person or entity that is not a Priority Customer, the Exchange believes that using the term “non-Priority Customer” is more clear in describing the types of market participant to which the allocation applies, and also reduces confusion regarding any reference to Professional Orders or Professional Customer orders.

In addition, the Exchange proposes to make universal changes in its Facilitation and Solicitation rules<sup>12</sup> to clearly delineate between orders and Responses<sup>13</sup> of the same capacity. For example, where the existing rule text currently states “Priority Customer bids (offers),” the Exchange proposes instead to state “Priority Customer Orders and Priority Customer Responses to buy (sell).” The Exchange notes that this is merely a non-substantive change as auction orders

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<sup>10</sup> See Securities Exchange Act Release No. 86947 (September 12, 2019), 84 FR 49165 (September 18, 2019) (SR-ISE-2019-21).

<sup>11</sup> Specifically in Options 3, Section 11, the Exchange will amend current subsections (a)(2)(B), (b)(3)(A)-(C) (renumbered to (b)(4)(A)-(C) under this proposal), (c)(7)(A)-(C), (d)(2)(C) (renumbered to (d)(3)(C) under this proposal), and (e)(4)(D). In Options 3, Section 13, the Exchange will amend current subsections (d)(1)-(3) and (e)(5)(i)-(iii).

<sup>12</sup> Specifically in Options 3, Section 11, subsections (b)(3)(A)-(C) (renumbered to (b)(4)(A)-(C)), and (d)(2)(A) and (C) (renumbered to (d)(3)(A) and (C)) will be updated.

<sup>13</sup> A “Response” is an electronic message that is sent by Members in response to a broadcast message. See Options 3, Section 11.

and Responses of the same capacity do not get treated differently for allocation purposes today. The rules for complex Facilitation and Solicitation already distinguish between orders and Responses, so the Exchange is simply amending those complex rules to clearly state how, for example, Priority Customer Complex Orders and Priority Customer Responses get allocated today<sup>14</sup> With the proposed changes, the Exchange seeks to include a similar level of detail within its simple and complex Facilitation and Solicitation rules in order to bring transparency around how allocation takes place in those auction mechanisms today.

### Block Order Mechanism

The Exchange proposes minor changes to the current descriptions of the Block execution and allocation process in Options 3, Section 11(a). As discussed below, the proposed Block changes are non-substantive in nature, and are intended to harmonize with the Block rule on its affiliated market, BX Options (“BX”) in order to ensure rule consistency between the Exchange and its affiliate offering identical functionality.

First, the Exchange proposes to add “up to the size of the block order” at the end of subsection (a)(2)(A). As amended, the rule will provide that bids (offers) on the Exchange at the time the block order is time the block order is executed that are priced higher (lower) than the block execution price, as well as Responses that are priced higher (lower) than the block execution price, will be executed in full at the block execution price up to the size of the block order. The Exchange is making this non-substantive change to align with BX’s Block rule,<sup>15</sup> which will ensure rule consistency for identical functionality across affiliated markets. The language states that better priced interest gets executed in full only if there is sufficient size to

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<sup>14</sup> See Options 3, Section 11(c)(7) and (e)(4).

<sup>15</sup> See BX Options 3, Section 11(a)(2)(A).

execute against such interest, which is how block orders are executed and priced on the Exchange and BX today.

Second, the Exchange proposes a non-substantive change in the first sentence of subsection (a)(2)(B) to replace “first and in time priority” with “first in price time priority.” As amended, the rule will provide that at the block execution price, Priority Customer Orders and Priority Customer Responses will be executed first in price time priority. This is not a change to the current Block allocation methodology, but rather a non-substantive change for better readability, and to align with BX’s Block rule<sup>16</sup> in order to ensure rule consistency for identical functionality across affiliated markets. Block orders will continue to trade at a single execution price that allows the maximum number of contracts of the block order to be executed against both the Responses entered to trade against the order and unrelated interest on the Exchange’s order book.

### **Example 1**

Block order is entered to buy 50 contracts @ 1.50

The following Responses are received:

Priority Customer Response 1 to sell 40 contracts @ 1.40

Priority Customer Response 2 to sell 10 contracts @ 1.40

Priority Customer Response 3 to sell 10 contracts @ 1.39

The block execution price would be \$1.40 (i.e., the price at which the maximum number of contracts could be executed) and would be executed as follows:

Block order trades 10 with Priority Customer Response 3 @ 1.40

Block order trades 40 with Priority Customer Response 1 @ 1.40

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<sup>16</sup> See BX Options 3, Section 11(a)(2)(B).

As shown above, Priority Customer Response 3 would be executed in full since it is priced better than the block execution price and there is sufficient size to execute Response 3 against the block order, while Priority Customer Responses 1 and 2, which are priced at the block execution price, would participate in price time priority – i.e., the remaining 40 contracts would go to Response 1, which was received before Response 2.

### Facilitation Mechanism

The Exchange proposes a number of changes to its Facilitation rule, none of which will change the current operation of this technology offering. Many of the proposed changes are intended to align the simple Facilitation rule in Options 3, Section 11(b) with the complex Facilitation rule in Options 3, Section 11(c) where relevant. In October 2018, the Exchange amended its complex order rules to provide greater clarity and additional detail regarding the operation and applicability of complex order functionality, including complex auction mechanisms like complex Facilitation.<sup>17</sup> Accordingly, the Exchange seeks to make aligning changes and update its simple auction mechanism rules to similarly provide the level of detail that now exists in its complex auction mechanism rules. The proposed changes are also intended to align with the simple Facilitation rules of the Exchange’s affiliated markets, Nasdaq GEMX (“GEMX”) and Nasdaq MRX (“MRX”). The Exchange also proposes to more accurately describe how orders will be allocated in Facilitation’s “auto-match” functionality.

In Options 3, Section 11(b), the Exchange proposes to add new subsection (b)(1),<sup>18</sup> which

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<sup>17</sup> See Securities Exchange Act Release No. 84373 (October 5, 2018), 83 FR 51730 (October 12, 2018) (SR-ISE-2018-56) (“Complex Order Filing”). As discussed later in this filing, the Complex Order Filing also clarified the Exchange’s complex Solicitation and PIM rules, and the Exchange is proposing to align the simple Solicitation and PIM rules with the complex rules where possible.

<sup>18</sup> As a result, current subsections (b)(1) - (3) will be renumbered as (b)(2) - (4). The Exchange will also renumber current subsection (b)(3)(D) as subsection (b)(5).

will provide that Orders must be entered into the Facilitation Mechanism at a price that is (A) equal to or better than the NBBO on the same side of the market as the agency order unless there is a Priority Customer order on the same side Exchange best bid or offer, in which case the order must be entered at an improved price; and (B) equal to or better than the ABBO<sup>19</sup> on the opposite side. Orders that do not meet these requirements are not eligible for the Facilitation Mechanism and will be rejected. The Exchange is not proposing any other changes to the current entry requirements for Facilitation. The new subsection (b)(1) would simply provide additional detail about simple Facilitation's existing entry checks, and align to the level of detail currently within the complex Facilitation rule regarding entry checks.<sup>20</sup>

### **Example 2**

Assume the following market:

ISE BBO: 1 x 2 (also NBBO)

CBOE: 0.75. x 2.25 (next best exchange quote)

Facilitation order is entered to buy 50 contracts @ 2.05

No Responses are received.

The Facilitation order executes with resting 50 lot quote @ 2. In this instance, the Facilitation order is able to begin crossed with the contra side ISE BBO because in execution, the resting 50 lot quote @ 2 is able to provide price improvement to the facilitation order.

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<sup>19</sup> The term "Away Best Bid or Offer" or "ABBO" means the displayed National Best Bid or Offer not including the Exchange's Best Bid or Offer. See Options 1, Section 1(a)(4).

<sup>20</sup> See Options 3, Section 11(c)(1) and (c)(2). Complex Facilitation refers to the Exchange's best bid or offer instead of the NBBO or ABBO. There is no NBBO for complex orders as complex orders may be executed without consideration of any prices that might be available on other exchanges trading the same options contracts. See Options 3, Section 14(d). Additionally, executions of legs of complex orders are exceptions to the prohibition on trade-throughs. See Options 5, Section 2(b)(7).

In renumbered subsection (b)(2), the Exchange proposes to add language to describe the content of the broadcast message sent to Members upon entry of an order into simple Facilitation. In particular, the Exchange proposes to specify that the broadcast message includes the series, price and size of the Agency Order, and whether it is to buy or sell. Although this change reflects current functionality, the existing rule is silent in this regard and only indicates that a broadcast message is sent upon the order's entry into the mechanism. Identical language currently exists in the rules governing simple Facilitation on GEMX and MRX, which operate in the same way as ISE's simple Facilitation.<sup>21</sup>

In renumbered subsection (b)(3), the Exchange proposes to replace the words "must not exceed" with "will only be considered up to" in order to align with identical language in the complex Facilitation rule.<sup>22</sup> This change more accurately describes that the System will cap Responses to the size of the auction for purposes of allocation methodology.

In renumbered subsection (b)(4)(A), the Exchange proposes to provide that the facilitation order will be cancelled at the end of the exposure period if an execution would take place at a price that is inferior to the best bid (offer) on the Exchange. This is a non-substantive change that makes clear that any executions in Facilitation will comply with the general prohibition on trade-throughs in Options 5, Section 2(a). Identical language is included in the rules governing simple Facilitation on GEMX and MRX.<sup>23</sup>

In renumbered subsections (b)(4)(B) and (b)(4)(C), the Exchange proposes to amend the rule to provide that the facilitating Member will be allocated up to forty percent (40%) (or such

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<sup>21</sup> See GEMX and MRX Options 3, Section 11(b)(1).

<sup>22</sup> See Options 3, Section 11(c)(6).

<sup>23</sup> See GEMX and MRX Options 3, Section 11(b)(3).



lower percentage requested by the Member) of the original size of the facilitation order. If the Member requests a lower allocation percentage, the contra-side order would receive an allocation consistent with the percentage requested by the Member. Regardless of the Member's request, the contra-side order would still be responsible for executing up to the full size of the agency order if there is not enough interest to execute the agency order at a particular price. Similar language indicating that the Member may request a lower allocation percentage than 40% is currently included in the complex Facilitation rule, which operate in the same way as the simple Facilitation in this manner.<sup>24</sup> For greater consistency between its simple and complex Facilitation rules, the Exchange also proposes to make aligning, non-substantive changes in the complex Facilitation rule to provide that the Member will "be allocated up to" forty percent. The current complex Facilitation language provides that the Member will "execute at least forty percent" or that the Member will "be allocated at least forty percent."<sup>25</sup> The non-substantive language proposed for complex Facilitation will therefore serve to harmonize the complex rule with the amended simple rule.

The Exchange also proposes to more accurately describe Facilitation's auto-match functionality, which provides an enhanced price improvement opportunity for the agency order by permitting the contra-side order to further participate in the cross by auto-matching the price and size of competing interest providing price improvement from other market participants.<sup>26</sup>

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<sup>24</sup> See Options 3, Section 11(c)(7)(B) and (C). Other options exchanges such as BX provide similar functionality that allows members using an auction mechanism to configure allocation priority. See, e.g., BX Options 3, Section 13, which provides a similar feature for the BX Options Price Improvement Auction ("PRISM") called "Surrender."

<sup>25</sup> Id.

<sup>26</sup> See Securities Exchange Act Release No. 62644 (August 4, 2010), 75 FR 48395 (August 10, 2010) (SR-ISE-2010-61) ("Auto-Match Filing"). As discussed later in this filing, the Auto-Match Filing also introduced the auto-match feature on PIM. As such, the

The rule currently provides that upon entry of an order into the Facilitation Mechanism, the facilitating Electronic Access Member can elect to automatically match the price and size of orders, quotes and responses received during the exposure period up to a specified limit price or without specifying a limit price. In this case, the facilitating Electronic Access Member will be allocated its full size at each price point, or at each price point within its limit price if a limit is specified, until a price point is reached where the balance of the order can be fully executed.<sup>27</sup>

The Exchange proposes to state that if a Member elects to auto-match, the facilitating Electronic Access Member will be allocated the aggregate size of all competing quotes, orders, and Responses (instead of “its full size”) at each price point, or at each price point up to the specified limit price (instead of “within its limit price”) if a limit is specified, until a price point is reached where the balance of the order can be fully executed. The Exchange believes that the modified language more accurately explains how the functionality works today, and better aligns with how this feature is described in the Auto-Match Filing.<sup>28</sup> For greater consistency within its Rulebook, the Exchange will also make the same changes in the complex Facilitation auto-match rule in Options 3, Section 11(c)(7)(C).

Lastly, the Exchange proposes to add at the end of Supplementary Material .01 to Options 3, Section 11 that any solicited contra orders entered by Members into the Facilitation

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Exchange is proposing to make similar changes in PIM’s auto-match rule as proposed for Facilitation’s auto-match rule.

<sup>27</sup> See Options 3, Section 11(b)(3)(C) (renumbered to Section 11(b)(4)(C) under this proposal).

<sup>28</sup> The Auto-Match Filing describes the auto-match feature as allowing the initiating member to submit a contra-side order that will automatically match the price and size set forth by the competing interest from other market participants (i.e., auction responses, quotes, and orders) at any price level during the auction or up to a specified limit price if a limit is specified.

Mechanism to trade against Agency Orders may not be for the account of a Nasdaq ISE Market Maker that is assigned to the options class.<sup>29</sup> This language was included in the approval order to SR-ISE-2006-78 to allow solicited transactions in ISE's Facilitation Mechanism, so the proposed change will import that prohibition into the rule text for greater transparency.

#### Solicited Order Mechanism

The Exchange proposes a number of changes to its Solicitation rule, none of which will change the current operation of this technology offering.

In Options 3, Section 11(d), the Exchange proposes to add new subsection (d)(1),<sup>30</sup> which will provide that orders must be must be entered into the Solicited Order Mechanism at a price that is equal to or better than the NBBO on both sides of the market; provided that, if there is a Priority Customer order on the Exchange best bid or offer, the order must be entered at an improved price. Orders that do not meet these requirements are not eligible for the Solicited Order Mechanism and will be rejected. The Exchange is not proposing any other changes to the current entry requirements for Solicitation. The new subsection (d)(1) would simply provide additional detail about simple Solicitation's existing entry checks, and align to the level of detail currently within the complex Solicitation rule regarding entry checks.<sup>31</sup>

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<sup>29</sup> See Securities Exchange Act Release No. 55557 (March 29, 2007), 72 FR 16838 (April 5, 2007) (SR-ISE-2006-78) (Order Granting Approval of Proposed Rule Change Relating to Facilitation Mechanism).

<sup>30</sup> As a result, current paragraphs (d)(1) - (3) will be renumbered accordingly. The Exchange will also renumber current paragraph (d)(2)(D) as paragraph (d)(4).

<sup>31</sup> See Options 3, Section 11(e)(1). Complex Solicitation refers to the Exchange's best bid or offer instead of the NBBO. As noted above, there is no NBBO for complex orders, and executions of legs of complex orders are exceptions to the prohibition of trade-throughs. See supra note 20.

### **Example 3**

Assume the following market:

ISE BBO: 1 x 2 (also NBBO)

CBOE: 0.75. x 2.25 (next best exchange quote)

Solicitation order is entered to buy 500 contracts @ 2.05

The Solicitation order is rejected upon entry for being crossed with the NBBO on the contra side.

In contrast to Example 2 above for Facilitation, the Solicitation order in this instance is not able to begin crossed with the contra side ISE BBO because of the all-or-none contingency of the Solicitation order.<sup>32</sup>

In renumbered subsection (d)(2), the Exchange proposes to add language to describe the content of the broadcast message sent to Members upon entry of an order into simple Solicitation. In particular, the Exchange proposes to specify that the broadcast message includes the series, price and size of the Agency Order, and whether it is to buy or sell. While this change reflects current functionality, the existing rule is silent in this regard and only indicates that a broadcast message is sent upon the order's entry into the mechanism. Identical language already exists in the rules governing simple Solicitation on GEMX and MRX, which operate in the same way as the ISE's simple Solicitation.<sup>33</sup>

Lastly, the Exchange also proposes technical changes in renumbered subsection (d)(3) to correct the internal lettering and cross-cites within paragraphs (A) through (C).

#### **Price Improvement Mechanism**

The Exchange proposes a number of changes to the PIM rule, none of which will change

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<sup>32</sup> See Options 3, Section 11(d) (requiring that each Solicitation order be designated as all-or-none).

<sup>33</sup> See GEMX and MRX Options 3, Section 11(d)(1).

the current operation of this technology offering. As noted above, many of these modifications are similar to the changes proposed for Facilitation.

The Exchange proposes in Options 3, Section 13(b)(2) to delete “national best bid or offer” as NBBO is already defined in subsection (b)(1) above. The Exchange proposes in subsection (c)(2) to provide that responses in the PIM (i.e., “Improvement Orders”) will only be considered up to the size of the Agency Order. The proposed amendment will specify that the System will cap the size of the Improvement Orders to the auction size for purposes of the allocation methodology. This is similar to the change proposed above for simple Facilitation, and also aligns to identical language in the complex PIM rule.<sup>34</sup> The Exchange also proposes in subsection (c)(3) to amend the internal numbering from (1) and (2) to (i) and (ii) for greater numbering consistency within the PIM rule.

In subsection (d)(3), which describes how allocation and execution takes place in simple PIM, the Exchange proposes that the Counter-Side Order will be allocated the greater of one contract or 40% (or such lower percentage requested by the Member) of the initial size of the Agency Order. Similar to Facilitation as discussed above, the System currently permits Members entering orders into PIM to elect to receive a percentage allocation that is less than 40%, although the current rule is silent in this regard. If the Member requests a lower allocation percentage, the Counter-Side Order would receive an allocation consistent with the percentage requested by the Member. Regardless of the Member’s request, the Counter-Side Order would still be responsible for executing up to the full size of the agency order if there is not enough interest to execute the agency order at a particular price. Complex PIM, which shares the same allocation feature as simple PIM, already has this concept within the rule, so the proposed

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<sup>34</sup> See Options 3, Section 13(e)(4)(i).

changes will align the simple PIM rule with the complex PIM rule.<sup>35</sup>

The Exchange also proposes to more accurately describe PIM's auto-match functionality in a similar manner as Facilitation's auto-match functionality, as discussed above. In this instance, the Exchange proposes to amend the third sentence of subsection (d)(3) to provide: "If a Member elects to auto-match, the Counter-Side Order will be allocated the aggregate size of all competing quotes, orders, and Responses at each price point up to the specified limit price if a limit is specified, until a price point is reached where the balance of the order can be fully executed." Similar to the proposed amendments to simple Facilitation's auto-match, the Exchange believes that the proposed language for simple PIM's auto-match more clearly explains how the functionality works today, and better aligns with how this feature is described in the Auto-Match Filing. For greater consistency within its Rulebook, the Exchange will also make the same changes in the complex PIM auto-match rule in Options 3, Section 13(e)(5)(iii).

The Exchange further proposes technical amendments in subsection (d)(3) to replace all instances of "Counter-Side order" as "Counter-Side Order" to use the correct terminology. Lastly, the Exchange proposes to provide in Supplementary Material .04 to Options 3, Section 13 that PIMs will not queue or overlap in any manner, except as described in Options 3, Section 11(f) and (g). Sections 11(f) and (g) set forth the governing provisions for concurrent complex auctions and concurrent complex and simple auctions. The proposed changes to add in the cross-cites to Sections 11(f) and (g) will make clear that two simple or two complex PIM auctions are not permitted to run concurrently, but that a simple PIM auction may run concurrently with a complex PIM auction.

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<sup>35</sup> See Options 3, Section 13(e)(5)(iii). As noted above, BX has a similar feature called Surrender for its PRISM auction. See supra note 24.

### Trade Value Allowance

The Exchange proposes a non-substantive change to amend the TVA rule in Supplementary Material .03 to Options 3, Section 14 to add a cross-cite to the complex PIM rule in Options 3, Section 13, which was inadvertently omitted when the Exchange relocated the complex auctions rules in a prior filing.<sup>36</sup> In SR-ISE-2019-05, the original cross-cite within the TVA rule was updated from Supplementary Material .08 to Rule 722 to Rule 716 (now Options 3, Section 11). Supplementary Material .08 to Rule 722 set forth the complex auction mechanism rules, namely complex Facilitation, Solicitation, and PIM. SR-ISE-2019-05 relocated complex Facilitation and Solicitation to Rule 716 (now Options 3, Section 11), but moved complex PIM to Rule 723 (now Options 3, Section 13). As such, the original cross-cite in the TVA rule should have been updated to include complex PIM in Rule 723 but was inadvertently omitted.

TVA is a functionality that allows complex orders to trade outside of their expected notional trade amount by a specified amount. The amount of TVA permitted may be determined by the Member, or a default value determined by the Exchange and announced to Members.<sup>37</sup> The TVA rule currently provides, however, that any amount of TVA is permitted in auction mechanisms pursuant to Options 3, Section 11 when auction orders do not trade solely with their contra-side order. The Exchange now proposes to add a cross-cite to Options 3, Section 13 to specify that TVA also applies to complex PIM auctions in this manner. The Exchange will also provide that TVA applies to “complex” mechanisms in the cited rules. These changes will align the rule text to how TVA is presently implemented in the System. The Exchange notes that its

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<sup>36</sup> See Securities Exchange Release No. 85308 (March 13, 2019), 84 FR 10136 (March 19, 2019) (SR-ISE-2019-05).

<sup>37</sup> See Supplementary Material .03 to Options 3, Section 14.

complex auction mechanisms provide an opportunity for market participants to respond with better-priced interest that could execute against an Agency Order. As such, the Exchange believes that it is appropriate to ensure that paired orders entered into complex Facilitation, Solicitation and PIM that are broken up due to better-priced interest are actually executed against such better-priced interest, and are not restricted from trading due to TVA settings of one or more Members.

#### Anti-Internalization

The Exchange proposes to amend its anti-internalization (“AIQ”) rule in Options 3, Section 15(a)(3)(A). Specifically, the Exchange proposes to add that AIQ does not apply during the opening process or reopening process following a trading halt pursuant to Options 3, Section 8 to provide more specificity on how this functionality currently operates. The Exchange notes that the same procedures used during the opening process are used to reopen an option series after a trading halt, and therefore proposes to specify that AIQ will not apply during an Opening Process (i.e., the opening and halt reopening process) in addition to an auction, as currently within the Rule. AIQ is unnecessary during an Opening Process due to the high level of control that Market Makers exercise over their quotes during this process. The proposed changes will align the Exchange’s AIQ rule with BX’s AIQ rule, which sets forth materially identical functionality.<sup>38</sup>

#### Exposure Mechanism

Under the linkage rules, the Exchange cannot execute orders at a price that is inferior to the NBBO, nor can the Exchange place an order on its book that would cause the Exchange best

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<sup>38</sup> See BX Options 3, Section 15(c)(1).



bid or offer to lock or cross another exchange's quote.<sup>39</sup> In these circumstances, Supplementary Material .02 to Options 5, Section 2 sets forth an Exposure mechanism for automated order handling where eligible incoming orders are exposed at the NBBO to all Members to give them an opportunity to execute the order at the NBBO price or better. The Exchange proposes to make clear within Supplementary Material .02 that an incoming order will be eligible for Exposure if the order is priced at or through the ABBO, when the ABBO is better than the Exchange BBO.

Supplementary Material .02 to Options 5, Section 2 currently provides that when the automatic execution of an incoming order would result in an impermissible Trade-Through, such order would be exposed at the current NBBO to all Exchange Members for a time period established by the Exchange not to exceed one (1) second. Supplementary Material .01 to Options 5, Section 3, however, currently provides that when the price of an incoming limit order that is not executable upon entry would lock or cross a Protected Quotation, such order would be handled in accordance with the Exposure process in Supplementary Material .02 to Options 5, Section 2.<sup>40</sup> The Exchange proposes to modify Supplementary Material .02 by removing the portion related to the automatic execution of an incoming order that would result in an impermissible Trade-Through, and instead providing within this Rule that Exposure will initiate when an incoming order is priced **at or** through the ABBO, when the ABBO is better than the Exchange BBO. The current language in Supplementary Material .02 only specifies that Exposure is initiated when the price of the incoming order is crossed with the ABBO (i.e., would

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<sup>39</sup> See Options 5, Sections 2 and 3. See also Options 3, Section 5(d)

<sup>40</sup> Such order would also be handled in accordance with Supplementary Material .04 (Non-Customer Orders that opt out of the Exposure mechanism) or .05 (Sweep Orders) to Options 5, Section 2, as applicable. See Supplementary Material .01 to Options 5, Section 3.

result in an impermissible Trade-Through), but does not specify the scenario in Supplementary Material .01 to Options 5, Section 3 when the price is locked. As such, the proposed changes seek to enhance the accuracy of the rules by codifying both scenarios within the Exposure rule in Supplementary Material .02.

#### Technical Amendments

The Exchange proposes technical changes in the Supplementary Material to Options 3, Section 11. First, the Exchange proposes in Supplementary Material .03 to update an incorrect cross-cite from Options 3, Section 22(d) to Section 22(b), which limits principal transactions. Second, the Exchange will make corrective changes to renumber Supplementary Material .07 to .05, and to update the cross-cite to paragraph (a)(2)(i) therein to paragraph (a)(2)(A). Third, the Exchange proposes in renumbered Supplementary Material .07 to update the reference to “Block Mechanism” to “Block Order Mechanism” to use the correct terminology.

Lastly, the Exchange proposes some harmonizing changes throughout its Rulebook to align with the rule numbering and titles with that of its affiliates. Specifically, the Exchange proposes to add a new Options 4B and reserve it in the Rulebook in order to harmonize its Options Rule numbering with that of its affiliates, GEMX and Nasdaq PHLX LLC (“Phlx”). The Exchange also proposes to retitle General 4 (currently titled “Regulation”) to “Registration Requirements” to harmonize its General Rule titles with that of its affiliates The Nasdaq Stock Market LLC and Nasdaq BX, Inc.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>41</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>42</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest.

The Exchange believes that its proposal is consistent with the protection of investors and public interest as all of the proposed changes will increase transparency around how various existing Exchange mechanisms work today. As such, no System changes to existing functionality are being made pursuant to this proposal. Rather, this proposal is designed to reduce any potential investor confusion as to the features and applicability of certain functionality presently available on the Exchange.

Furthermore, many of the proposed changes seek to provide greater harmonization between the rules of the Exchange and its affiliates (notably rules related to Block, Facilitation, Solicitation, and AIQ), or between the Exchange's own simple and complex auction rules (notably for simple and complex Facilitation, Solicitation, and PIM).<sup>43</sup> The Exchange believes that these harmonizing changes would result in greater uniformity, and ultimately less burdensome and more efficient regulatory compliance by market participants. As such, the proposed rule change would foster cooperation and coordination with persons engaged in

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<sup>41</sup> 15 U.S.C. 78f(b).

<sup>42</sup> 15 U.S.C. 78f(b)(5).

<sup>43</sup> As noted above, the Exchange seeks to add granularity to its simple auction rules to align with the level of detail that currently exists within its complex auction rules. See supra note 17.

facilitating transactions in securities and would remove impediments to and perfect the mechanism of a free and open market and a national market system. The Exchange also believes that more consistent rules will increase the understanding of the Exchange's operations for Members that are also members on the Exchange's affiliates, thereby contributing to the protection of investors and the public interest.

Specifically, the Exchange believes that the proposed universal changes to replace all instances of Professional interest with non-Priority Customer interest throughout the Exchange's auction allocation rules will add greater consistency within the Exchange's rules. As discussed above, the Exchange previously made the same modifications within its standard allocation rule in Options 7, Section 10, so the proposed changes will promote more consistent terminology in the rules and make them easier for market participants to navigate and comprehend. The Exchange also believes that using the term "non-Priority Customer" reduces any potential confusion regarding any reference to Professional Orders or Professional Customer orders. In addition, the Exchange believes that clearly delineating between orders and Responses of the same capacity in the Facilitation and Solicitation rules will bring clarity and transparency around how allocation takes place in those auction mechanisms. The complex Facilitation and Solicitation rules currently differentiate between orders and Responses,<sup>44</sup> so the Exchange is aligning the simple rule to the level of granularity already found in the complex rule while also specifying the capacity of such order or Response within the simple and complex rules. As noted above, the Exchange is not changing the current allocation methodology, and auction orders and Responses of the same capacity do not get treated differently for allocation purposes today.

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<sup>44</sup> See supra note 14.

The Exchange believes that the proposed changes to the Block rule are consistent with the protection of investors and the public interest as the modifications will more accurately reflect the handling of auctions in Block, specifically as it relates to execution and allocation. The proposed changes will specify that better priced interest entered into Block gets executed in full only if there is sufficient size to execute against such interest, and that Priority Customer interest gets executed first in price time priority. This specificity will be helpful to market participants utilizing Block and provide greater certainty as to how their Block orders will be executed and allocated. The Exchange also believes that the proposed changes will continue to ensure a fair and orderly market by maintaining and protecting the priority of Priority Customer orders, while still affording the opportunity for all market participants to seek liquidity and potential price improvement during each Block auction commenced on the Exchange. As noted above, the Exchange is not proposing any changes to the current execution or allocation methodology but believes that the changes will promote consistency with the rulebook of its affiliated exchange BX, which offers identical functionality.<sup>45</sup>

Similarly, the Exchange believes that specifying the entry checks for simple Facilitation and Solicitation is consistent with the protection of investors and the public interest by providing greater consistency to the level of granularity currently within the complex Facilitation and Solicitation entry checks.<sup>46</sup> The Exchange also believes it is appropriate to require that the Facilitation order be entered at an improved price if there is a Priority Customer order on the same side Exchange best bid or offer as the agency order. The Exchange believes this will ensure a fair and orderly market by maintaining priority of orders and quotes and protecting

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<sup>45</sup> See supra notes 15-16, and accompanying text.

<sup>46</sup> See supra notes 20 and 31, and accompanying text.

Priority Customer orders, while still affording the opportunity to seek liquidity and for potential price improvement during each Facilitation auction commenced on the Exchange. For the same reasons, the Exchange believes that it is appropriate to require that the Solicitation order be entered at an improved price if there is a Priority Customer order on the Exchange best bid or offer.

The Exchange further believes that it is consistent with the Act to specify the contents of the broadcast message sent to Members upon entry of an order into simple Facilitation and Solicitation as the changes will remove any potential confusion about what type of auction information is disseminated. Currently, the broadcast message in simple Facilitation and Solicitation includes the series, price, and size of the Agency Order, and whether it is to buy or sell. As this information is helpful to auction participants, the Exchange believes that codifying this information into the simple Facilitation and Solicitation rules may encourage greater participation within these mechanisms, thereby increasing the opportunity for options orders to receive executions on the Exchange. The Exchange is not proposing any changes to the current content of the broadcast message but wants to make this clear in its rules, which, with this change, would be consistent with the rules of its affiliated exchanges that offer identical functionality.<sup>47</sup> Likewise, the proposed change to add that a facilitation order would be cancelled at the end of the exposure period if an execution would take place at a price that is inferior to the best bid (offer) on the Exchange is intended to ensure compliance with the general prohibition on trade-throughs in Options 5, Section 2(a), and to ensure consistency across the rules of the Exchange and its affiliates that offer identical functionality.<sup>48</sup>

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<sup>47</sup> See supra notes 21 and 33.

<sup>48</sup> See supra note 23.

The proposed changes to replace “must not exceed” with “will only be considered up to” in the simple Facilitation and PIM rules are intended to more accurately describe that the System will cap the size of Responses to the size of the agency order for purposes of allocation. The Exchange is not amending current System behavior; rather, the modifications will more clearly articulate the handling of Responses by the System. In addition, the proposed changes will serve to harmonize the simple and complex auction rules, thereby resulting in greater uniformity and ultimately less burdensome and more efficient regulatory compliance by market participants.<sup>49</sup>

The Exchange believes that its proposal to specify in the simple Facilitation and PIM rules that an initiating Member may elect to receive a percentage allocation lower than 40% is consistent with the Act. This feature provides an initiating Member that submits an order into Facilitation or PIM with the flexibility to configure its allocation percentage up to the full 40% entitlement. The Exchange notes that regardless of the Member’s instruction, the contra-side order would still be responsible for executing up to the full size of the agency order if there is not enough interest to execute the agency order at a particular price. The Exchange continues to believe that the 40% allocation entitlement is consistent with the statutory standards for competition and free and open markets by promoting price competition within Facilitation and PIM as Members would still have a reasonable opportunity to compete for a significant percentage of the incoming order. The Exchange also notes that the configurable 40% allocation entitlement for simple Facilitation and PIM is consistent with the configurable allocation entitlements in place on complex Facilitation and PIM as well as on its affiliated exchange, BX.<sup>50</sup> Accordingly, the Exchange believes that the proposed changes will promote consistency

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<sup>49</sup> See supra notes 22 and 34.

<sup>50</sup> See supra notes 24 and 35.

across the rulebooks of exchanges offering identical functionality and within its own Rulebook as well.

With respect to the proposed changes to the Facilitation and PIM auto-match feature, the Exchange is amending the current rule text so that it more accurately explains how the Exchange will allocate an order designated for auto-match today. As discussed above, the Exchange is not making any substantive changes to the allocation procedure itself; rather the proposed changes are intended to better align how this feature is described in the Auto-Match Filing.<sup>51</sup> Similarly, the Exchange believes that the proposed change in Supplementary Material .01 to Options 3, Section 11 to add the provision that any solicited contra orders entered by Members into the Facilitation Mechanism to trade against Agency Orders may not be for the account of a Nasdaq ISE Market Maker that is assigned to the options class will better align the rule text with related filing. As discussed above, this restriction was included in the approval order to the rule filing that allowed solicited transactions in the Facilitation Mechanism, so the Exchange will import that language into the rule text for greater transparency.<sup>52</sup>

The proposed change in Supplementary Material .04 to Options 3, Section 13 to provide that PIMs will not queue or overlap in any manner, except as described in Options 3, Section 11(f) and (g) will make clear that two simple or complex PIM auctions are not permitted to run concurrently, but that a simple PIM auction may run concurrently with a complex PIM auction. The Exchange believes that this change will reduce any potential confusion around how simultaneous PIM auctions are processed by the System.

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<sup>51</sup> See supra note 28.

<sup>52</sup> See supra note 29.



The Exchange believes that the proposed change to the TVA rule is a non-substantive change to say that any amount of TVA is permitted in complex PIM (in addition to all of the other complex auction mechanisms in Options 3, Section 11). This is a corrective change as the cross-cite to complex PIM within the TVA rule was inadvertently dropped in a prior filing that relocated the complex auction rules.<sup>53</sup> As noted above, the Exchange's complex auction mechanisms provide an opportunity for market participants to respond with better-priced interest that could execute against an Agency Order. Accordingly, the Exchange believes that it is appropriate to ensure that paired orders entered into complex Facilitation, Solicitation and PIM that are broken up due to better-priced interest are actually executed against such better-priced interest, and are not restricted from trading due to TVA settings of one or more Members.

The Exchange believes its proposal to provide that AIQ will not apply during an Opening Process (i.e., the opening process or halt reopening process) will more accurately state how this functionality currently operates. AIQ prevents Market Makers from trading against their own quotes and orders. While the Exchange believes that this protection is useful for Market Makers to manage their trading during regular market hours, applying AIQ is unnecessary during an Opening Process due to the high level of control that Market Makers already exercise over their quotes during this process. Furthermore, the proposed AIQ changes will promote consistency with the rulebook of its affiliated exchange BX, which offers identical functionality.<sup>54</sup>

The Exchange believes that its proposal to provide that Exposure will initiate when an incoming order is priced at or through the ABBO, when the ABBO is better than the Exchange BBO, is consistent with the Act. As discussed above, the current language in Supplementary

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<sup>53</sup> See supra note 36.

<sup>54</sup> See supra note 38.

Material .02 only specifies that Exposure is initiated when the price of the incoming order is crossed with the ABBO (i.e., would result in an impermissible Trade-Through), but does not specify the scenario in Supplementary Material .01 to Options 5, Section 3 when the price is locked. Supplementary Material .01 to Options 5, Section 3, however, also currently provides that when the price of an incoming limit order that is not executable upon entry would lock or cross a Protected Quotation, such order would be handled in accordance with the Exposure process in Supplementary Material .02 to Options 5, Section 2. As such, the proposed changes will enhance the accuracy of the rules by codifying both scenarios within the Exposure rule in Supplementary Material .02, and will continue to ensure that such order complies with the general prohibition on trade-throughs in Options 5, Section 2(a).

The Exchange further believes that the technical changes it is proposing throughout Options 3 are non-substantive changes intended to enhance the accuracy of the Exchange's Rulebook, which will alleviate potential confusion as to the applicability of its rules. As discussed above, these changes consist of updating internal rule lettering and cross-cites, and using correct terminology. Lastly, the Exchange believes that the harmonizing changes to add a new Options 4B in its Rulebook and to retitle General 4, each as discussed above, will serve to further harmonize its Rule numbering and titling with that of its affiliates, thereby promoting efficiency and conformity of its processes with those of its affiliated exchanges.

**B. Self-Regulatory Organization's Statement on Burden on Competition**

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. As indicated above, no System changes to existing functionality are being made pursuant to this proposal; rather, this proposal is designed to reduce any potential investor confusion as to the features and

applicability of certain functionality presently available on the Exchange. Therefore, the proposed changes are designed to enhance clarity and consistency in the Exchange's Rulebook.

Furthermore, many of the proposed changes seek to provide greater harmonization between the rules of the Exchange and its affiliates, and therefore promotes fair competition among the options exchanges. In particular, the proposed changes discussed above for Block and AIQ are based on BX rules governing identical functionality,<sup>55</sup> and the Facilitation and Solicitation changes around broadcast message content and trade-through prohibition compliance (Facilitation only) are based on GEMX and MRX rules governing identical functionality.<sup>56</sup> The Exchange notes that it operates in a highly competitive market in which market participants can readily direct order flow to competing venues who offer similar functionality. The Exchange believes that the proposed rule change will enhance competition among the various markets for auction execution, potentially resulting in more active trading in auction mechanisms across all options exchanges.

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time

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<sup>55</sup> See BX Options 3, Section 11(a) (Block) and Section 15(c)(1) (AIQ).

<sup>56</sup> See GEMX and MRX Options 3, Section 11(b)(1) (Facilitation broadcast message), Options 3, Section 11(d)(1) (Solicitation broadcast message), and Options 3, Section 11(b)(3) (Facilitation executions trade-through compliance).

as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>57</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>58</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-ISE-2021-01 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.

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<sup>57</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>58</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

All submissions should refer to File Number SR-ISE-2021-01. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549-1090 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-ISE-2021-01, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>59</sup>

J. Matthew DeLesDernier  
Assistant Secretary

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<sup>59</sup> 17 CFR 200.30-3(a)(12).