

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-80581; File No. SR-Phlx-2017-04)

May 3, 2017

Self-Regulatory Organizations; NASDAQ PHLX LLC; Notice of Filing of Amendment No. 1 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change, as Modified by Amendment No. 1, to Permit the Listing and Trading of P.M.-settled NASDAQ-100 Index® Options on a Pilot Basis

I. Introduction

On January 18, 2017, NASDAQ PHLX LLC (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² a proposed rule change to permit the listing and trading of P.M.-settled NASDAQ-100 Index® (“NASDAQ-100”) options on a pilot basis. The proposed rule change was published for comment in the Federal Register on February 3, 2017.³ On March 14, 2017, the Commission extended the time period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.⁴ On May 2, 2017, the Exchange filed Amendment No. 1 to the proposed rule change.⁵ The Commission received no comment letters on the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 79894 (January 30, 2017), 82 FR 9259 (“Notice”).

⁴ See Securities Exchange Act Release No. 80241, 82 FR 14393 (March 20, 2017).

⁵ In Amendment No. 1, the Exchange revised its proposal to add that raw percentage price change data as well as percentage price change data normalized for prevailing market volatility, as measured by an appropriate index as agreed by the Commission and the Exchange, would be provided as part of the pilot data. When the Exchange filed Amendment No. 1 with the Commission, it also submitted Amendment No. 1 to the public comment file for SR-Phlx-2017-04 (available at: www.sec.gov/comments/sr-phlx-2017-04/phlx201704.htm).

The Commission is publishing this notice and order to solicit comments on the proposed rule change, as modified by Amendment No. 1, from interested persons and to institute proceedings pursuant to Section 19(b)(2)(B) of the Act⁶ to determine whether to approve or disapprove the proposed rule change, as modified by Amendment No. 1.

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

The Exchange is proposing to amend its rules to permit the listing and trading, on a pilot basis, of NASDAQ-100 options with third-Friday-of-the-month expiration dates, whose exercise settlement value will be based on the closing index value, symbol XQC, of the NASDAQ-100 on the expiration day (“P.M.-settled”).

The Exchange represents that the conditions for listing the proposed contract (“NDXPM”) on Phlx will be similar to those for Full Value Nasdaq 100 Options (“NDX”), which are already listed and trading on Phlx, except that NDXPM will be P.M.-settled.⁷ In particular, NDXPM will use a \$100 multiplier, and the minimum trading increment will be \$0.05 for options trading below \$3.00 and \$0.10 for all other series. Strike price intervals will be set at no less than \$5.00. Consistent with existing rules for index options, the Exchange will allow up to nine near-term expiration months, as well as LEAPS. The product will have European-style exercise and will not be subject to position limits, though there would be enhanced reporting requirements.⁸

As proposed, the proposal would become effective on a pilot basis for period of twelve months (“Pilot Program”). If the Exchange were to propose an extension of the Pilot Program or

⁶ 15 U.S.C. 78s(b)(2)(B).

⁷ See Notice, supra note 3, at 9260.

⁸ For a more detailed description of the proposed NDXPM contract, see Notice, supra note 3.

should the Exchange propose to make the Pilot Program permanent, then the Exchange would submit a filing proposing such amendments to the Pilot Program. The Exchange notes that any positions established under the pilot would not be impacted by the expiration of the pilot. For example, a position in a P.M.-settled series that expires beyond the conclusion of the pilot period could be established during the 12-month pilot. If the Pilot Program were not extended, then the position could continue to exist. However, the Exchange notes that any further trading in the series would be restricted to transactions where at least one side of the trade is a closing transaction.

The Exchange proposes to submit a Pilot Program report to Commission at least two months prior to the expiration date of the Pilot Program (the “annual report”). The annual report would contain an analysis of volume, open interest, and trading patterns. The analysis would examine trading in the proposed option product as well as trading in the securities that comprise the NASDAQ-100. In addition, for series that exceed certain minimum open interest parameters, the annual report would provide analysis of index price volatility and share trading activity. In addition to the annual report, the Exchange would provide the Commission with periodic interim reports while the pilot is in effect that would contain some, but not all, of the information contained in the annual report. The annual report would be provided to the Commission on a confidential basis. The annual report would contain the following volume and open interest data:

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

(6) month-end open interest for each individual series.

In addition to the annual report, the Exchange would provide the Commission with interim reports of the information listed in Items (1) through (6) above periodically as required by the Commission while the Pilot Program is in effect. These interim reports would also be provided on a confidential basis. The annual report would also contain the information noted in Items (1) through (6) above for Expiration Friday, A.M.-settled NASDAQ-100 options traded on Phlx.

In addition, the annual report would contain the following analysis of trading patterns in Expiration Friday, P.M.-settled NASDAQ-100 option series in the Pilot Program: (1) a time series analysis of open interest; and (2) an analysis of the distribution of trade sizes. Also, for series that exceed certain minimum parameters, the annual report would contain the following analysis related to index price changes and underlying share trading volume at the close on Expiration Fridays: a comparison of index price changes at the close of trading on a given Expiration Friday with comparable price changes from a control sample. The data would include a calculation of percentage price changes for various time intervals and compare that information to the respective control sample. Raw percentage price change data as well as percentage price change data normalized for prevailing market volatility, as measured by an appropriate index as agreed by the Commission and the Exchange, would be provided. The Exchange would provide a calculation of share volume for a sample set of the component securities representing an upper limit on share trading that could be attributable to expiring in-the-money series. The data would include a comparison of the calculated share volume for securities in the sample set to the average daily trading volumes of those securities over a sample period. The minimum open

interest parameters, control sample, time intervals, method for randomly selecting the component securities, and sample periods would be determined by the Exchange and the Commission.⁹

III. Proceedings to Determine Whether to Approve or Disapprove SR-Phlx-2017-04, as Modified by Amendment No. 1, and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act¹⁰ to determine whether the proposed rule change, as modified by Amendment No. 1, should be approved or disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change, as discussed below. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as stated below, the Commission seeks and encourages interested persons to provide comments on the proposed rule change, as modified by Amendment No. 1.

Pursuant to Section 19(b)(2)(B) of the Act,¹¹ the Commission is providing notice of the grounds for disapproval under consideration, as discussed below. In particular, Section 6(b)(5) of the Act¹² requires that the rules of an exchange be designed, among other things, to prevent fraudulent and manipulative acts and practices, 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.

⁹ See Notice, supra note 3, at 9261 and Amendment No. 1. The proposed Pilot Program for NDXPM options is similar to the pilot program approved for the listing and trading of P.M.-settled S&P 500 Index options (“SPXPM options”). See Securities Exchange Act Release No. 64011 (March 2, 2011), 76 FR 12775, 12776-77 (March 8, 2011) (“SPXPM Notice”).

¹⁰ 15 U.S.C. 78s(b)(2)(B).

¹¹ Id.

¹² 15 U.S.C. 78f(b)(5).

The Commission has had concerns about the potential adverse effects and impact of P.M. settlement upon market volatility and the operation of fair and orderly markets on the underlying cash market at or near the close of trading, including for cash-settled derivatives contracts based on a broad-based index.¹³ The Commission believes that the proposal to allow P.M. settlement of an option on the NASDAQ-100 raises questions as to the potential effects on the underlying cash equities markets, and thus as to whether it is consistent with the requirements of Section 6(b)(5) of the Act, including whether the proposal is designed to prevent manipulation, promote just and equitable principles of trade, perfect the mechanism of a free and open market and the national market system, and protect investors and the public interest.

Accordingly, the Commission solicits comment, analysis, and data concerning whether the Exchange's proposal is consistent with the Act. The Commission is asking commenters to address the merits of Phlx's statements in support of its proposal, in addition to any other comments they may wish to submit about the proposed rule change or any data or analysis that commenters think may be relevant to the Commission's consideration of the proposal. Specifically, the Commission seeks input from commenters to inform its evaluation of whether P.M. settlement for Phlx's proposed options on the NASDAQ-100 could impact volume and volatility on the underlying cash equities markets at the close of the trading day, and the potential consequences this might have for investors and the overall stability of the markets.

In addition, the Commission seeks input from commenters with respect to the operation

¹³ For a detailed discussion of the history of the concerns related to such P.M. settlement, see Securities Exchange Act Release Nos. 64599 (June 3, 2011), 76 FR 33798, 33801-02 (June 9, 2011) (order instituting proceedings to determine whether to approve or disapprove a proposed rule change to allow the listing and trading of SPXPM options) and 65256 (September 2, 2011), 76 FR 55969, 55970-76 (September 9, 2011) (order approving proposed rule change to establish a pilot program to list and trade SPXPM options).

and structure of the markets today in comparison to their operation and structure at the time of the shift to A.M. settlement of cash-settled index options, and whether the current operation and structure of the markets support, or do not support, allowing NASDAQ-100 options on Phlx to be P.M.-settled.

More generally, the Commission seeks commenters' views on whether there are differences between Phlx's proposed product and other P.M.-settled, cash-settled options that raise novel issues and, if so, whether commenters believe such differences warrant different treatment or a different pilot design.

As noted above, the Exchange's proposal seeks to allow the listing and trading of NDXPM options on a pilot basis, and the Pilot Program, including its associated data and reports, are key in assisting the Commission and its staff to analyze the impact of the proposal, including with respect to the concerns described above. Thus, the Commission is considering and requesting comment on whether commenters believe the proposed Pilot Program is appropriate. As noted above, the proposed Pilot Program is similar to the pilot program for the listing and trading of SPXPM options.¹⁴ The Commission requests commenters' views on whether the proposed Pilot Program would adequately demonstrate whether the Commission's concerns about the adverse effect and impact of P.M. settlement are, or are not, implicated by the listing and trading of P.M.-settled options on the NASDAQ-100 and, if not, what information or data the pilot should include. The Commission seeks public comment on whether there are differences between the listing and trading of SPXPM options and the proposed NDXPM options that would warrant differences in the data, analyses, or reports that should be required for the Exchange's proposed pilot. In addition, Amendment No. 1 of the proposal added that "[r]aw

¹⁴ See SPXPM Notice, supra note 9.

percentage price change data as well as percentage price change data normalized for prevailing market volatility, as measured by an appropriate index as agreed by the Commission and the Exchange” would be included as part of the pilot. The Commission seeks input on what commenters believe would be appropriate data to use with respect to measuring volatility for the proposed pilot.

Finally, the Commission requests any comment, data, or analysis that commenters think may be relevant to the Commission’s consideration of the Exchange’s proposal for P.M.-settled options on the NASDAQ-100.

IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposal. In particular, the Commission invites the written views of interested persons concerning whether the proposal, as modified by Amendment No. 1, is consistent with Section 6(b)(5) or any other provision of the Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.¹⁵

Interested persons are invited to submit written data, views, and arguments regarding whether the proposal, as modified by Amendment No. 1, should be approved or disapproved by

¹⁵ Section 19(b)(2) of the Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding – either oral or notice and opportunity for written comments – is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

[insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register].

Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-Phlx-2017-04 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-Phlx-2017-04. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of these filings also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the

Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-Phlx-2017-04 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁶

Eduardo A. Aleman
Assistant Secretary

¹⁶ 17 CFR 200.30-3(a)(57).