

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-79812; File No. SR-BX-2016-063)

January 17, 2017

Self-Regulatory Organizations; NASDAQ BX, Inc.; Order Granting Approval of Proposed Rule Change to Amend the PRISM Price Improvement Auction in BX Chapter VI, Section 9 and to Make Pilot Program Permanent

I. Introduction

On November 21, 2016, NASDAQ BX, Inc. (“BX” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup>, and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend the eligibility requirements for its Price Improvement Auction mechanism (“PRISM” or “Auction”) and make permanent those aspects of the PRISM auction that are currently operating on a pilot basis. The proposed rule change was published for comment in the Federal Register on December 9, 2016.<sup>3</sup> The Commission received no comments regarding the proposal. This order approves the proposed rule change.

II. Description of the Proposal

The Exchange established PRISM in November 2015 as a price improvement mechanism.<sup>4</sup> Pursuant to Chapter VI, Section 9 of the BX Options Rules, a Participant (an “Initiating Participant”) may electronically submit for execution an order it represents as agent

---

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

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

<sup>3</sup> See Securities Exchange Act Release No. 79465 (December 5, 2016), 81 FR 89167 (“Notice”).

<sup>4</sup> See Securities Exchange Release No. 76301 (October 29, 2015), 80 FR 68347 (November 4, 2015) (SR-BX-2015-032) (“PRISM Approval Order”).

on behalf of a Public Customer,<sup>5</sup> Professional customer, broker dealer, or any other entity (“PRISM Order”) against principal interest or against any other order it represents as agent (an “Initiating Order”), provided it submits the PRISM Order for electronic execution into the Auction. Parts of PRISM are currently operating on a pilot basis (“Pilot”),<sup>6</sup> which is set to expire on January 18, 2017.<sup>7</sup> The Exchange proposes to make the Pilot permanent, and also proposes to amend the Auction eligibility requirements for certain PRISM Orders of less than 50 option contracts.

A. PRISM Eligibility Requirements for PRISM Orders of Fewer than 50 Contracts

Currently, a PRISM Auction may be initiated if certain conditions are met. If the PRISM Order is for the account of a Public Customer, the Initiating Participant must stop the entire PRISM Order at a price that is equal to or better than the National Best Bid/Offer (“NBBO”) on the opposite side of the market from the PRISM Order, provided that such price must be at least one minimum trading increment (specified in Chapter VI, Section 5 of the BX Options Rules) better than any limit order on the limit order book on the same side of the market as the PRISM

---

<sup>5</sup> A Public Customer means a person that is not a broker or dealer in securities. See Chapter I, Section 1(a)(50) of the BX Options Rules. A “Professional” means any person or entity that (i) is not a broker or dealer in securities, and (ii) places more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). A Participant or a Public Customer may, without limitation, be a Professional. All Professional orders shall be appropriately marked by Participants. See Chapter I, Section 1(a)(49) of the BX Options Rules. For purposes of PRISM rule, a Public Customer order does not include a Professional order. See Chapter VI, Section 9 of the BX Options Rules.

<sup>6</sup> Three components of PRISM were approved by the Commission on a pilot basis: (1) the early conclusion of the PRISM Auction; (2) the provision that an unrelated market or marketable limit order (against the BX BBO) on the opposite side of the market from the PRISM Order received during the Auction will not cause the Auction to end early and will execute against interest outside of the Auction; and (3) no minimum size requirement of orders.

<sup>7</sup> See Securities Exchange Act Release No. 78249 (July 7, 2016), 81 FR 45334 (July 13, 2016) (SR-BX-2016-038).

Order.<sup>8</sup> If the PRISM Order is for the account of a broker dealer or any other person or entity that is not a Public Customer, the Initiating Participant must stop the entire PRISM Order at a price that is the better of: (i) the BX BBO price improved by at least the minimum trading increment on the same side of the market as the PRISM Order, or (ii) the PRISM Order's limit price (if the order is a limit order), provided in either case that such price is at or better than the NBBO.<sup>9</sup>

BX proposes to amend the Auction eligibility requirements to require that, if the PRISM Order is for less than 50 option contracts, and if the difference between the NBBO is \$0.01, the Initiating Participant must stop the entire PRISM Order at one minimum price improvement increment better than the NBBO on the opposite side of the market from the PRISM Order, and better than any limit order on the limit order book on the same side of the market as the PRISM Order. Thus, BX would require that the PRISM Order receive at least \$0.01 price improvement if that PRISM Order is for less than 50 contracts and if the difference between the NBBO is \$0.01. This requirement will apply regardless of whether the PRISM Order is for the account of a Public Customer, or where the PRISM Order is for the account of a broker dealer or any other person or entity that is not a Public Customer.

The Exchange will retain the current requirements for Auction eligibility in all other instances. Accordingly, if the PRISM Order is for the account of a Public Customer and such order is for 50 option contracts or more or if the difference between the NBBO is greater than \$0.01, the Initiating Participant must stop the entire PRISM Order at a price that is equal to or better than the NBBO on the opposite side of the market from the PRISM Order, provided that such price must be at least one minimum trading increment better than any limit order on the

---

<sup>8</sup> See Chapter VI, Section 9(i)(A) of the BX Options Rules.

<sup>9</sup> See Chapter VI, Section 9(i)(B) of the BX Options Rules.

limit order book on the same side of the market as the PRISM Order. If the PRISM Order is for the account of a broker dealer or any other person or entity that is not a Public Customer and such order is for 50 option contracts or more, or if the difference between the NBBO is greater than \$0.01, the Initiating Participant must stop the entire PRISM Order at a price that is the better of: (i) the BX BBO price improved by at least the Minimum Increment on the same side of the market as the PRISM Order, or (ii) the PRISM Order's limit price (if the order is a limit order), provided in either case that such price is at or better than the NBBO.<sup>10</sup>

The Exchange believes that these changes to PRISM may provide additional opportunities for PRISM Orders of fewer than 50 option contracts to receive price improvement over the NBBO where the difference in the NBBO is \$0.01 and therefore encourage the increased submission of orders of fewer than 50 option contracts.<sup>11</sup> The Exchange notes that the statistics for the current pilot, which include, among other things, price improvement for orders of fewer than 50 option contracts under the current auction eligibility requirements, show

---

<sup>10</sup> The Exchange also proposes to add language to Chapter VI, Section 9(i) of the BX Options Rules to clarify that, if any of the auction eligibility criteria are not met, the PRISM Order will be rejected. The Exchange will also add language to Chapter VI, Section 9(i) to clarify the treatment of paired Public Customer-to-Public Customer orders pursuant to subparagraph (vi) as a result of these proposed changes. Specifically, Exchange will allow a PRISM Order to trade on either the bid or offer, pursuant to subparagraph (vi), if the NBBO is \$0.01 wide, provided (1) the execution price is equal to or within the NBBO, (2) there is no resting customer at the execution price, and (3) \$0.01 is the Minimum Price Variation (MPV) of the option. The Exchange also proposes to add language that it will continue to reject a PRISM Order to buy (sell) if the NBBO is only \$0.01 wide and the Agency order is stopped on the bid (offer) if there is a resting order on the bid (offer). These requirements are unchanged from the Exchange's current handling practices of paired Public Customer-to-Public Customer PRISM Orders per subparagraph (vi), and the Exchange's current practice of rejecting PRISM Orders to buy (sell) if the NBBO is only \$0.01 wide and the Agency order is stopped on the bid (offer) if there is a resting order on the bid (offer).

<sup>11</sup> See Notice, supra note 3, at 89169.

relatively small amounts of price improvement for such orders.<sup>12</sup> BX believes that the proposed requirements will therefore increase the price improvement that orders of fewer than 50 option contracts may receive in PRISM.<sup>13</sup> The Exchange also notes that NASDAQ PHLX LLC (“Phlx”) operates a similar price improvement mechanism, PIXL, which has been operating for a longer period of time and has generated similar pilot data.<sup>14</sup> Given the similarity between the two mechanisms, the Exchange expects that PRISM, if operated on a pilot basis over a longer period of time, would continue to generate data that is comparable to PIXL.<sup>15</sup>

B. Pilot Program

Three components of PRISM were approved by the Commission on a pilot basis: (1) the early conclusion of the PRISM Auction;<sup>16</sup> (2) the provision that an unrelated market or marketable limit order (against the BX BBO) on the opposite side of the market from the PRISM Order received during the Auction will not cause the Auction to end early and will execute against interest outside of the Auction;<sup>17</sup> and (3) no minimum size requirement of orders. The provisions were approved for a pilot period that currently expires on January 18, 2017.<sup>18</sup> The Exchange proposes to have the Pilot approved on a permanent basis.

During the Pilot period, the Exchange submitted certain data periodically as required by the Commission, to provide supporting evidence that, among other things, there is meaningful competition for all size orders, there is significant price improvement available through PRISM,

---

<sup>12</sup> See id.

<sup>13</sup> See id.

<sup>14</sup> See Securities Exchange Act Release No. 63027 (October 1, 2010), 75 FR 62160 (October 7, 2010) (SR-Phlx-2010-108).

<sup>15</sup> See Notice, supra note 3, at 89169.

<sup>16</sup> See Chapter VI, Section 9(ii)(B)(4) of the BX Options Rules.

<sup>17</sup> See Chapter VI, Section 9(ii)(D) of the BX Options Rules.

<sup>18</sup> See PRISM Approval Order, supra note 4.

and that there is an active and liquid market functioning on the Exchange outside of the Auction mechanism.<sup>19</sup>

1. No Minimum Size Requirement

Chapter VI, Section 9(vii) provides that, as part of the current Pilot, there will be no minimum size requirement for orders to be eligible for the Auction. The Exchange believes that the data gathered since the approval of the Pilot, which it discussed in the Notice, establishes that there is liquidity and competition both within PRISM and outside of PRISM, and that there are opportunities for significant price improvement within PRISM.<sup>20</sup>

The Exchange also has gathered information about activity in orders for less than 50 and 50 contracts or greater for PRISM auctions between January and June 2016. For auctions occurring during that period, 87.8% of auctions were for orders for less than 50 contracts, a percentage that remained stable over that time period. Auctions for orders of less than 50 contracts accounted for 30.0% of the contract volume traded in PRISM. Auctions of 50 contracts or more made up 12.2% of all PRISM auctions and accounted for 70.0% of contracts traded in PRISM.<sup>21</sup>

With respect to price improvement, 60.5% of PRISM auctions between January and June 2016 executed at a price that was better than the NBBO at the time the auction began.<sup>22</sup> For auctions of less than 50 contracts, 64.7% received price improvement, while 30.5% of auctions for 50 contracts or more received price improvement.<sup>23</sup>

---

<sup>19</sup> See Chapter VI, Section 9(vii).

<sup>20</sup> See Notice, supra note 3, at 89169. See also Exhibit 3 to SR-BX-2016-063.

<sup>21</sup> See Notice, supra note 3, at 89369.

<sup>22</sup> See id.

<sup>23</sup> See Notice, supra note 3, at 89170.

BX believes that the data gathered during the Pilot period indicates that there is meaningful competition in PRISM auctions for all size orders, there is an active and liquid market functioning on the Exchange outside of the auction mechanism, and that there are opportunities for price improvement for orders executed through PRISM.<sup>24</sup> The Exchange therefore has requested that the Commission approve the no minimum size requirement on a permanent basis.

2. Early Conclusion of the PRISM Auction

Chapter VI, Section 9(ii)(B)(4) of the BX Options Rules provides that the PRISM Auction shall conclude at the earlier of (1) the end of the Auction period; (2) any time the BX BBO crosses the PRISM Order stop price on the same side of the market as the PRISM Order; or (3) any time there is a trading halt on the Exchange in the affected series.<sup>25</sup> The latter two conditions are operating as part of the current Pilot.

As with the no minimum size requirement, the Exchange has gathered data on these latter two conditions. Between January and June 2016, one auction terminated early because the BX BBO crossed the PRISM Order stop price. No auctions terminated early because of halts. The number of auctions that terminated early was less than 1/100<sup>th</sup> of 1% of all PRISM auctions over

---

<sup>24</sup> See id.

<sup>25</sup> If the situations described in either of the two latter conditions occur, the entire PRISM Order will be executed at: (1) in the case of the BX BBO crossing the PRISM Order stop price, the best response price(s) or, if the stop price is the best price in the Auction, at the stop price, unless the best response price is equal to or better than the price of a limit order resting on the Order Book on the same side of the market as the PRISM Order, in which case the PRISM Order will be executed against that response, but at a price that is at least the Minimum Increment better than the price of such limit order at the time of the conclusion of the Auction; or (2) in the case of a trading halt on the Exchange in the affected series, the stop price, in which case the PRISM Order will be executed solely against the Initiating Order. Any unexecuted PAN responses will be cancelled.

the period. The auctions that terminated early were less than 1/100<sup>th</sup> of 1% of contracts traded in PRISM auctions.<sup>26</sup>

Based on the data gathered during the pilot, the Exchange does not anticipate that either of these conditions will occur with significant frequency, or will otherwise disrupt the functioning of PRISM auctions.<sup>27</sup> The Exchange therefore has requested that the Commission approve this aspect of the Pilot on a permanent basis.

### 3. Unrelated Market or Marketable Limit Order

Chapter VI, Section 9(ii)(D) of the BX Options Rules provides that an unrelated market or marketable limit order (against the BX BBO) on the opposite side of the market from the PRISM Order received during the Auction will not cause the Auction to end early and will execute against interest outside of the Auction. If contracts remain from such unrelated order at the time the auction ends, they will be considered for participation in the order allocation process described elsewhere in the Rule.

The Exchange states that the provision is based on a similar provision in the Phlx PIXL mechanism.<sup>28</sup> In approving this feature on PIXL, also on a pilot basis, the Commission found that “allowing the PIXL auction to continue for the full auction period despite receipt of unrelated orders outside the Auction would allow the auction to run its full course and, in so doing, will provide a full opportunity for price improvement to the PIXL Order. Further, the unrelated order would be available to participate in the PIXL order allocation.”<sup>29</sup> The Exchange does not believe that this provision has had a significant impact on either the unrelated order or

---

<sup>26</sup> See Notice, supra note 3, at 89170.

<sup>27</sup> See id.

<sup>28</sup> See Phlx Rule 1080(n)(ii)(D).

<sup>29</sup> See Securities Exchange Act Release No. 63027 (October 1, 2010), 75 FR 62160 (October 7, 2010) (SR-PHLX-2010-108).



the PRISM auction process.<sup>30</sup> The Exchange therefore has requested that the Commission approve this aspect of the Pilot on a permanent basis.

### III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, with Section 6(b) of the Act.<sup>31</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>32</sup> which requires, among other things, that the rules of a national securities 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 customers, issuers, brokers and dealers.

As part of its proposal, the Exchange provided summary data on Exhibit 3 of its filing for the period January through June 2016, which the Exchange and Commission both publicly posted on their respective websites. Among other things, this data is useful in assessing the level of price improvement in the auction, in particular for orders for fewer than 50 contracts; the degree of competition for order flow in such auctions; and a comparison of liquidity in the auctions with liquidity on the Exchange generally.<sup>33</sup> Based on the data provided by the

---

<sup>30</sup> See Notice, supra note 3, at 89170.

<sup>31</sup> 15 U.S.C. 78f(b). In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>32</sup> 15 U.S.C. 78f(b)(5).

<sup>33</sup> See Exhibit 3 to SR-BX-2016-063.

Exchange, the Commission believes that the Exchange's price improvement auction generally delivers a meaningful opportunity for price improvement to orders, including orders for fewer than 50 contracts, when the spread in the option is \$0.02 or more. At the same time, as the Exchange has recognized, the data do not demonstrate that such orders have realized significant price improvement when the NBBO has a bid/ask differential of \$0.01.<sup>34</sup> Recognizing this, the Exchange has proposed to amend the auction eligibility requirements to require price improvement of at least one minimum price improvement increment over the NBBO for PRISM Orders of less than 50 option contracts where the difference in the NBBO is \$0.01.

The Exchange's proposal to modify the auction eligibility requirements for orders of fewer than 50 contracts and seek permanent approval of the Pilot, as amended with the new provision, will, in the Commission's view, promote opportunities for price improvement for such orders when the NBBO is \$0.01 wide, while continuing to provide opportunities for price improvement when spreads are wider than \$0.01.

In addition, the Commission has carefully evaluated the PRIME Pilot data and has determined that it would be beneficial to customers and to the options market as a whole to approve on a permanent basis the provisions concerning early conclusion of the PRISM Auction, and the receipt of an unrelated market or marketable limit order (against the BX BBO) on the opposite side of the market from the PRISM Order during the Auction. The Commission notes that there have been few instances of early termination of the PRISM. The Commission further notes that permitting the PRISM Auction to continue despite receipt of unrelated orders outside the Auction would allow the Auction to run its full course and provide a full opportunity for

---

<sup>34</sup> See Notice, supra note 3, at 89169.

price improvement to the PRISM Order, while allowing the unrelated order to seek an execution, including in the Auction's order allocation.

The Commission believes that, particularly for auctions for fewer than 50 contracts when the bid/ask differential is wider than \$0.01, the data provided by the Exchange support its proposal to make the Pilot permanent. The data demonstrate that the auction generally provides price improvement opportunities to orders, including orders of retail customers and particularly when the bid/ask differential is wider than \$0.01, that there is meaningful competition for orders on the Exchange; and that there exists an active and liquid market functioning on the Exchange outside of the auction.<sup>35</sup> The Commission further believes that the proposed revisions to the eligibility requirements for PRISM Orders of fewer than 50 contracts with respect to circumstances when the NBBO is \$0.01 wide should help to enhance the operation of the auction by providing meaningful opportunities for price improvement in such circumstances, and should benefit investors and others in a manner that is consistent with the Act. Thus, the Commission has determined to approve the Exchange's proposed revisions to Chapter VI, Section 9(i) of the BX Options Rules and to approve the Pilot, as proposed to be modified, on a permanent basis.

---

<sup>35</sup> See Exhibit 3 to SR-BX-2016-063.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>36</sup> that the proposed rule change (SR-BX-2016-063), be and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>37</sup>

Eduardo A. Aleman  
Assistant Secretary

---

<sup>36</sup> 15 U.S.C. 78s(b)(2).

<sup>37</sup> 17 CFR 200.30-3(a)(12).