

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-81770; File No. SR-GEMX-2017-43)

September 29, 2017

Self-Regulatory Organizations; Nasdaq GEMX, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend Rule 716(c) on the Block Order Mechanism

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 September 18, 2017, Nasdaq GEMX, LLC (“GEMX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II, 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 Rule 716(c) to more accurately describe the allocation methodology used in the Block Order Mechanism, and add language regarding how the block execution price is determined.

The text of the proposed rule change is available on the Exchange’s Website at [www.ise.com](http://www.ise.com), 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 Block Order Mechanism is a process by which a member can obtain liquidity for the execution of block-sized orders,<sup>3</sup> defined as orders for fifty contracts or more.<sup>4</sup> When an order is entered in the Block Order Mechanism, that order is exposed to members who are given an opportunity to respond with the prices and sizes at which they would be willing to trade with the block-sized order.<sup>5</sup> The exposure period is designated by the Exchange via circular, but must be no less than 100 milliseconds and no more than 1 second.<sup>6</sup> At the conclusion of the exposure period, either an execution will occur at a single block execution price,<sup>7</sup> or the order will be cancelled.<sup>8</sup> The purpose of the proposed rule change is to amend Rule 716(c) to more accurately describe the allocation methodology used in the Block Order Mechanism, and add language regarding how the block execution price is determined. The Exchange believes that these changes will increase transparency around the operation of the Block Order Mechanism to the benefit of members and market participants.

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<sup>3</sup> See Rule 716(c).

<sup>4</sup> See Rule 716(a).

<sup>5</sup> A “Response” is an electronic message that is sent by members in response to a broadcast message. See Rule 716(b).

<sup>6</sup> See Supplementary Material .04 to Rule 716.

<sup>7</sup> Responses and orders and quotes on the order book at the time the block order is executed that are priced better than the block execution price are executed at the block execution price. See Rule 716(c)(2)(i).

<sup>8</sup> See Rule 716(c)(2).

Currently, Rule 716(c)(2)(ii) provides that Responses, quotes, and Professional Orders<sup>9</sup> at the block execution price will participate in the execution of the block-size order according to Rule 713(e) – i.e., the Exchange’s regular allocation rule. As implemented today, however, interest that is executed in the Block Order Mechanism follows the customer priority pro-rata allocation methodology designed for the Exchange’s auction mechanisms, including, for example, the Facilitation Mechanism,<sup>10</sup> Solicited Order Mechanism,<sup>11</sup> and Price Improvement Mechanism,<sup>12</sup> with the exception that those two-sided auction mechanisms also allocate contracts against the contra order. This auction allocation methodology is similar to the Exchange’s regular allocation methodology but does not provide enhanced allocations to the Primary Market Maker (“PMM”) pursuant to Rule 713(e) and Supplementary Material .01(b) to Rule 713.<sup>13</sup> The Exchange therefore proposes to amend Rule 716(c)(2)(ii) to provide that, at the block execution price, Priority Customer Orders and Priority Customer Responses will be executed first in time priority, and then quotes, Professional Orders, and Professional Responses will participate in the execution of the block-size order based upon the percentage of the total number of contracts available at the block execution price that is represented by the size of the quote, Professional Order, or Professional Response. In addition, the Exchange proposes to specify in Rule 716(c)(2)(i) that interest that is priced better than the block execution price is executed in full. In

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<sup>9</sup> The term “Professional Order” means an order that is for the account of a person or entity that is not a Priority Customer. See Rule 100(a)(37C).

<sup>10</sup> See Rule 716(d).

<sup>11</sup> See Rule 716(e).

<sup>12</sup> See Rule 723.

<sup>13</sup> Supplementary Material .01(b) to Rule 713 provides that, if the PMM is quoting at the best price, it has participation rights equal to the greater of the proportion of the total size at the best price represented by the size of its quote, or a percentage allocation entitlement based on the number of other Professional Orders and market maker quotations at the best price.

particular, the Exchange proposes to amend this rule to state that bids (offers) on the Exchange at the 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. Although Rule 716(c)(2)(ii) described above explains how allocations are handled at the block execution price, the Exchange believes that additional the additional clarity that interest that is priced better than the block execution price is executed in full would be helpful to members. With these two proposed changes, Rule 716(c) will more accurately describe the allocation methodology used in the Block Order Mechanism.

Furthermore, the Exchange proposes add language to Rule 716(c)(2)(i) that explains the price at which orders entered into the Block Order Mechanism are executed. In particular, the Exchange proposes to state that Responses, orders, and quotes will be executed at a single block execution price that is the price for the block-size order at which the maximum number of contracts can be executed consistent with the member's instruction. For example, if a member enters a block-sized order to buy 100 contracts at \$1.00 into the Block Order Mechanism, and members enter Response A to sell 50 contracts at \$0.90 and Response B to sell 40 contracts at \$0.95, the block execution price would be \$0.95 as this is the price at which the maximum number of contracts could be executed. The block-sized order and both Responses would then be executed at this single block execution price. Responses A and B would be executed in full since there is sufficient size to execute both Responses against the block-size order. In addition, if two other members also enter Responses C (Priority Customer) and D (non-Priority Customer) to sell at \$0.98 for 10 contracts each, the block execution price would be \$0.98 as additional contracts could be executed at that price. In that instance, Responses A and B, which are priced better than the block execution price, would be executed in full, while Responses B and C, which are priced

at the block execution price, would participate in accordance with the allocation methodology described in this proposed rule change – i.e., the remaining 10 contracts would go to Response C, which is a Priority Customer Response. The Block Order Mechanism is designed to provide an opportunity for members to receive liquidity for their block-sized orders and therefore trades at a price that allows the maximum number of contracts of such order to be executed against Responses entered to trade against the block-size order and interest on the Exchange’s order book. The Exchange believes that describing how the block execution price is determined in Rule 716(c)(2)(i) will increase transparency around pricing of executions in the Block Order Mechanism.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange, and, in particular, with the requirements of Section 6(b) of the Act.<sup>14</sup> In particular, the proposal is consistent with Section 6(b)(5) of the Act,<sup>15</sup> because is designed to promote just and equitable principles of trade, remove impediments to and perfect the mechanisms 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 the proposed changes to the allocation language in Rule 716(c)(2)(i)-(ii) are consistent with the protection of investors and the public interest as the proposed allocation language more accurately reflects the Exchange’s process for allocating contracts executed in the Block Order Mechanism. Although the Exchange’s allocation rule for the Block Order Mechanism currently references the allocation process for regular trading, the

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

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

allocation methodology does not include certain parts of the regular allocation procedure. In particular, the Exchange does not grant any special allocation to the PMM for interest executed in the Block Order Mechanism. The Exchange believes that it is appropriate to not provide an enhanced allocation entitlement to the PMM for interest executed in the Block Order Mechanism, as the Block Order Mechanism provides an auction process that does not rely on market maker quoting and other obligations to source liquidity. Furthermore, the Exchange believes that it is helpful to explain in this rule that interest that is priced better than the block execution price would be executed in full. The allocation process used for the Block Order Mechanism is similar to how the Exchange allocates contracts in other auction mechanisms, including, for example, the Facilitation Mechanism, Solicited Order Mechanism, and Price Improvement Mechanism, with the exception that those two-sided auction mechanisms also allocate contracts against the contra order.<sup>16</sup>

The Exchange also believes that the proposed changes to describe how the block execution price is determined is consistent with the protection of investors and the public interest as this change will increase transparency around the price at which interest is executed in the Block Order Mechanism. As explained above, the Block Order Mechanism is designed to provide an opportunity for members to receive liquidity for their block-sized orders and therefore trades at a price that allows the maximum number of contracts of such order to be executed against Responses entered to trade against the block-size order and interest on the Exchange's order book. The Exchange believes that describing how the block execution price is determined in Rule 716(c)(2)(i) will increase transparency around pricing of executions in the Block Order Mechanism.

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<sup>16</sup> See supra notes 10 – 12 and accompanying text.

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

In accordance with Section 6(b)(8) of the Act,<sup>17</sup> the Exchange does not believe that the proposed rule change will impose any burden on intermarket or intramarket competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule change is designed to correct the Exchange's rules to more accurately reflect the handling of auctions in the Block Order Mechanism. No changes are proposed to the operation of the Exchange's trading system, and no members will be impacted by the proposed rule, which merely reflects current functionality offered to members that trade in the Block Order Mechanism. The proposed rule change is therefore not designed to impose any significant burden on competition.

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 as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>18</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>19</sup>

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<sup>17</sup> 15 U.S.C. 78f(b)(8).

<sup>18</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>19</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.

A proposed rule change filed under Rule 19b-4(f)(6)<sup>20</sup> normally does not become operative prior to 30 days after the date of the filing. However, pursuant to Rule 19b-4(f)(6)(iii),<sup>21</sup> the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange requests that the Commission waive the 30-day operative delay. The Exchange notes that a waiver is consistent with the protection of investors and the public interest because it will allow the Exchange to correct its Block Order Mechanism rules to reflect the current functionality of the system without undue delay. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest. Accordingly, the Commission hereby waives the 30-day operative delay and designates the proposed rule change operative upon filing.<sup>22</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: (i) necessary or appropriate in the public interest; (ii) for the protection of investors; or (iii) 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:

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<sup>20</sup> 17 CFR 240.19b-4(f)(6).

<sup>21</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>22</sup> For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

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-GEMX-2017-43 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-GEMX-2017-43. 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 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; 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-GEMX-2017-43 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>23</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>23</sup> 17 CFR 200.30-3(a)(12).