

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-82362; File No. SR-ISE-2017-106)

December 19, 2017

Self-Regulatory Organizations; Nasdaq ISE, LLC; Notice of Filing of Proposed Rule Change to Permit the Listing and Trading of NQX Index Options

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 6, 2017, 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 permit the listing and trading of options based on 1/5 the value of the Nasdaq-100 Index (“Nasdaq-100”) on a twelve month pilot basis.

The text of the proposed rule change is available on the Exchange’s Website at <http://ise.cchwallstreet.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 Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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 the Exchange's rules to permit the listing and trading of index options on the Nasdaq 100 Reduced Value Index ("NQX") on a twelve month pilot basis. The NQX options contract will be the same in all respects as the current Nasdaq-100 ("NDX") options contract listed on the Exchange,³ except that it will be based on 1/5 of the value of the Nasdaq-100, and will be P.M.-settled with an exercise settlement value based on the closing index value of the Nasdaq-100 on the day of expiration.⁴ The Exchange believes that the proposed contract will be valuable for retail and other investors that wish to trade reduce value options on the Nasdaq-100, or who wish to hedge positions in the related E-mini Nasdaq 100 ("NQ") futures contract, which is also based on 1/5 the value of the Nasdaq-100.

I. Nasdaq-100 Index

The Nasdaq-100 is a modified market capitalization-weighted index that includes 100 of the largest non-financial companies listed on The Nasdaq Stock Market ("Nasdaq"),⁵ based on market capitalization.⁶ It does not contain securities of financial companies, including investment companies. Security types generally eligible for the Nasdaq-100 include common stocks, ordinary shares, American Depository Receipts, and tracking stocks. Security or company types

³ See Securities Exchange Act Release No. 51121 (February 1, 2005), 70 FR 6476 (February 7, 2005) (SR-ISE-2005-01) (Approval Order).

⁴ In addition to the current Nasdaq-100 index value, Nasdaq will disseminate an index value for NQX that is 1/5 of the value of the Nasdaq-100.

⁵ Nasdaq is an affiliate of the Exchange.

⁶ The Nasdaq-100 is a broad-based index, as defined in Rule 2001(k).

not included in the Nasdaq-100 are closed-end funds, convertible debentures, exchange traded funds, limited liability companies, limited partnership interests, preferred stocks, rights, shares or units of beneficial interest, warrants, units and other derivative securities.⁷

II. NQX Options Contract

Currently, the Exchange lists and trades NDX options that are based on the full value of the Nasdaq-100. In an effort to attract additional interest in index options based on the Nasdaq-100, the Exchange now proposes to list and trade a new reduced value option contract based on this index on a twelve month pilot basis. NQX options will trade independently of and in addition to NDX options, and the NQX options will be subject to the same rules that presently govern the trading of index options based on the Nasdaq-100, including sales practice rules, margin requirements, trading rules, and position and exercise limits. Similar to NDX, NQX options will be European-style and cash-settled, and will have a contract multiplier of 100. The contract specifications for NQX options will mirror in all respects those of the NDX options contract already listed on the Exchange, except that the Exchange proposes that NQX options will be based on 1/5 of the value of the Nasdaq-100, and will be P.M.-settled pursuant to proposed Rule 2009(a)(6). Similar features are available with other index options contracts listed and/or approved for trading on the Exchange and other options exchanges, including the Exchange's affiliate, Nasdaq Phlx ("Phlx"). Specifically, options contracts based on 1/10 the value of the Nasdaq-100, i.e., "MNX" options, are listed on the Exchange with limited strikes, and are also currently listed on Phlx and the Chicago Board Options Exchange ("CBOE"). In addition, Phlx recently received approval to trade P.M.-settled options on the full value of the

⁷ A description of the Nasdaq-100 is available on Nasdaq's website at https://indexes.nasdaqomx.com/docs/methodology_NDX.pdf.

Nasdaq-100 (“NDXPM”).⁸

The value of the Nasdaq-100 has increased significantly in recent years such that the value of the index stood at 6,242.47, as of the opening of trading on December 5, 2017. As a result of the increase in the value of the underlying Nasdaq-100 index, the premium for NDX options has also increased. The Exchange believes that this has caused NDX options to trade at a level that may be uncomfortably high for certain retail and other investors. The Exchange believes that listing options on reduced values will attract a greater source of retail customer business. The Exchange further believes that listing options on reduced values will provide an opportunity for investors to trade and hedge the market risk associated with the Nasdaq-100.

With an exercise settlement value based on 1/5 of the Nasdaq-100, the Exchange believes that retail and other investors would be able to use this trading vehicle while extending a smaller outlay of capital. Furthermore, the proposed reduced value index will have a notional value at a level that is comparable to similar products that have been successful in the market, including the S&P 500, which had an index value of 2,639.78 as of the opening of trading on December 5, 2017, and the Russell 2000, which had an index value of 1,532.72 as of the opening of trading on that date. Finally, options based on 1/5 of the value of the Nasdaq-100 will be a particularly useful hedge, as NQ futures are similarly based on the value of 1/5 of the value of the Nasdaq-100. The Exchange therefore believes that basing the proposed NQX options contract on 1/5 of the value of the Nasdaq-100 should attract additional investors, and, in turn, create a more active and liquid trading environment.

NQX options will also be P.M.-settled as the Exchange believes that market participants, and in particular, retail investors, who are the target audience for this product, prefer P.M.-settled

⁸ See Securities Exchange Act Release No. 81293 (August 2, 2017), 82 FR 37138 (August 8, 2017) (SR-Phlx-2017-04) (Approval Order).

index options. P.M.-settlement is preferred by retail investors as it allows market participants to hedge their exposure for the full week. A.M.-settled options by contrast are based on opening prices on the day of expiration and therefore stop trading on the day prior, leaving residual risk on the day of expiration. Feedback from members that handle retail order flow has indicated that P.M.-settlement is needed to garner retail investor support for this product. In this regard, the Exchange notes that there is ample precedent for P.M.-settlement of broad-based index options. As described above, the Exchange's affiliate, Phlx, recently received approval to list NDXPM options. In addition, CBOE offers P.M.-settled index options based on both the Standard & Poor's 500 index ("SPXW"),⁹ and the Standard & Poor's 100 index ("OEX").¹⁰

The Exchange does not believe that the introduction of a new P.M.-settled Nasdaq-100 contract will cause any market disruptions. Similar to other P.M.-settled index option products, the Exchange is proposing to list and trade NQX options contracts pursuant to a pilot, and will provide data to the Commission during the pilot period as described in Section VI below. The Exchange will monitor for any disruptions caused by P.M.-settlement of the proposed NQX options contract or the development of any factors that could cause such disruptions. P.M.-settled options predominate in the over-the-counter ("OTC") market, and the Exchange is not aware of any adverse effects in the OTC market attributable to the P.M.-settlement feature. The Exchange is merely proposing to offer a P.M.-settled product in an exchange environment, which offers the additional benefits of added transparency, price discovery, and stability.

III. Trading Hours, Minimum Increments, Expirations and Strike Prices

NQX options will be available for trading during the Exchange's standard trading hours

⁹ See Securities Exchange Act Release No. 80060 (February 17, 2017), 82 FR 11673 (February 24, 2017) (SR-CBOE-2016-091) (Approval Order).

¹⁰ OEX has been P.M. settled since 1983.

for index options, i.e., from 9:30 a.m. to 4:15 p.m. New York time,¹¹ with a minimum trading increment of \$0.05 for options trading below \$3.00 and \$0.10 for all other series.¹² NQX options will have monthly expiration dates on the third Friday of each month (i.e., Expiration Friday), and the Exchange proposes to list NQX options in expiration months consistent with those of other index option products available on the Exchange.¹³ In addition, the Exchange may list long-term index options series (“LEAPS”) that expire from twelve (12) to sixty (60) months from the date of issuance.¹⁴ NQX options would also be eligible to be added to the Short Term Option Series Program (“Weeklies”) and/or Quarterly Options Series Program (“Quarterlies”) if designated by the Exchange pursuant to Supplementary Material .01 or .02 to Rule 2009, respectively.¹⁵

Generally, pursuant to Rule 2009(c)(1), index options listed on the Exchange are subject to strike price intervals of no less than \$5, provided that certain classes of index options (including NDX and MNX) have strike price intervals of no less than \$2.50 if the strike price is less than \$200. The Exchange proposes to amend Rule 2009(c)(1) to add NQX options to the list of classes where strike price intervals of no less than \$2.50 are generally permitted if the strike price is less than \$200. In addition, Rule 2009(c)(5) provides finer strike price intervals for MNX options as these contracts are based on a reduced value of the Nasdaq-100. Specifically, Rule

¹¹ See Rule 2008(a).

¹² See Rule 710(a).

¹³ See Rule 2009(a)(3). Rule 2009(a)(3) currently provides that the Exchange may list up to six expiration months in index option contracts at any one time that may expire at three-month intervals or in consecutive months. The Exchange intends to file separately to modify the expiration months permitted for index option contracts consistent with Phlx Rule 1101A(b).

¹⁴ See Rule 2009(b).

¹⁵ The Exchange expects that it will add NQX options to the Weeklies program.

2009(c)(5) provides that notwithstanding Rule 2009(c)(1) discussed above, the interval between strike prices of series of MNX options will be \$1 or greater, subject to certain conditions. The Exchange proposes to adopt the same strike price intervals for NQX options as currently approved for MNX options. Thus, notwithstanding Rule 2009(c)(1), the interval between strike prices of series of NQX options will be \$1 or greater, subject to the conditions described in Rule 2009(c)(5), which currently apply to the listing of strikes in reduced value MNX contracts. The Exchange will not list LEAPS on NQX options at intervals less than \$5. If the Exchange determines to add NQX options to the Weeklies or Quarterlies programs such options will be listed with expirations and strike prices described in Supplementary Material .01 or .02 to Rule 2009.

IV. Position and Exercise Limits; Margin

As with NDX, in determining compliance with Rule 2004 – i.e., Position Limits for Broad-Based Index Options – there will be no position limits for broad-based index option contracts in the NQX class. Although there will be no position limits for NQX options, the Exchange proposes to amend Rule 2004(c) to correctly describe how positions in reduced-value options would be aggregated with full-value options. Rule 2004(c) provides that positions in reduced-value index options shall be aggregated with positions in full-value indices. In addition, the rule currently states that for such purposes, ten reduced-value contracts shall equal one contract, as this was consistent with other reduced-value contracts offered on the Exchange – i.e., MNX, which is based on 1/10 of the value of the Nasdaq-100. Since the Exchange is proposing to list a reduced-value NQX contract that is based on 1/5 of the value of the Nasdaq-100, the Exchange proposes to amend this language to state instead that reduced-value contracts will be counted consistent with their value (e.g., 5 NQX reduced-value contracts equal 1 NDX full-value

contract). With this change, the rule will more accurately reflect how the Exchange would aggregate reduced-value and full-value positions for NQX. In addition, as with NDX, there would be no exercise limits for NQX.¹⁶ Finally, the Exchange proposes to apply broad-based index margin requirements for the purchase and sale of NQX options that are the same as margin requirements currently in place for NDX options.

V. Surveillance and Capacity

The Exchange represents that it has sufficient capacity to handle additional quotations and message traffic associated with the proposed listing and trading of NQX options. In addition, index options are integrated into the Exchange's existing surveillance system architecture and are thus subject to the relevant surveillance processes. The Exchange represents that it has adequate surveillance procedures to monitor trading in NQX options thereby aiding in the maintenance of a fair and orderly market.

VI. Pilot Program Reports

The Exchange proposes to list and trade NQX options on a pilot basis for period of twelve months (“Pilot Program”). If the Exchange were to propose an extension of the program or should the Exchange propose to make the program permanent, then the Exchange would submit a filing proposing such amendments to the 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 an NQX options series that expires beyond the conclusion of the pilot period could be established during the 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

¹⁶ See Rule 2007(a), which provides that exercise limits for index options products are equivalent to the position limits in place for those products.

transaction.

The Exchange proposes to submit a Pilot Program report to the 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:¹⁷

- (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 is in effect. These interim reports would also be provided on a confidential basis.

¹⁷ Based on the data elements to be provided to the Commission for the NDXPM pilot. See supra note 7

Finally, the annual report would contain the following analysis of trading patterns in Expiration Friday, P.M.-settled NQX option series in the pilot: (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. 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.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,¹⁸ in general, and furthers the objectives of Section 6(b)(5) of the Act,¹⁹ 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. Specifically, the Exchange believes that the listing and trading of a reduced value P.M.-settled index option contract based on the Nasdaq-

¹⁸ 15 U.S.C. 78f(b).

¹⁹ 15 U.S.C. 78f(b)(5).

100 will attract order flow to the Exchange, increase the variety of listed options, and provide a valuable hedge tool to retail and other investors.

The Exchange believes that the proposed rule change will further the Exchange's goal of introducing new and innovative products to the marketplace. Specifically, the Exchange believes that NQX options would provide additional opportunities for market participants to trade and hedge exposure to the Nasdaq-100. The proposed NQ [sic] options product is similar to NDX options that are currently listed and traded on the Exchange with two important differences: (1) NQX options will be based on 1/5 the value of the Nasdaq-100, and (2) NQX options will be P.M.-settled. These differences are based on the Exchange's experience listing NDX options, and are designed to attract additional participation from retail and other investors. Based on feedback received from members, the Exchange believes that the proposed contract specifications will be attractive to market participants, and will remove impediments to and perfect the mechanism of a free and open market and a national market system.

Currently, the Exchange believes that there is unmet market demand for exchange-listed index options on the Nasdaq-100. This unmet demand stems in part from the high value of the Nasdaq-100 and the consequently higher cost of purchasing NDX options. The value of the Nasdaq-100 was 6,242.47, as of the opening of trading on December 5, 2017, and this high value has made it more difficult for retail and other investors to comfortably purchase options on the index. The Exchange believes that a reduced value index option would allow additional participation from these investors. Specifically, the Exchange believes that basing the contract on a reduced value of the Nasdaq-100 will encourage additional participation by retail and other investors due to the reduced capital outlay needed to trade these options. While the Exchange previously listed a reduced value MNX contract that product never attracted significant trading

volume. The Exchange believes that basing NQX options on 1/5 the value of the Nasdaq-100 strikes a more appropriate balance than the MNX product that is based on 1/10 the value of this index, as this value is more similar to other competitive index option products and is also helpful for market participants that want to hedge exposure to NQ futures that are similarly based on 1/5 the value of the Nasdaq-100.

Furthermore, based on member feedback, the Exchange believes that providing P.M.-settlement will make this product more attractive to market participants and help garner additional support for this new index options product. Specifically, the Exchange believes that P.M.-settlement will be attractive to retail and other investors that want to use these options to hedge an entire week of risk without leaving residual risk on the day of expiration, and without having to actively manage these positions, for example, by rolling their hedge into the next expiration. For this reason, other popular index option products have been transitioning to P.M.-settlement. For example, due to market demand for P.M.-settlement, CBOE recently transitioned its heavily traded SPX index options to P.M.-settlement, and removed related A.M.-settled products.²⁰ The Exchange believes that market participants similarly desire P.M.-settlement for index options on the Nasdaq-100, and proposes to offer such a product so that it can compete effectively with similar index option products offered by CBOE.

When cash-settled index options were first introduced in the 1980s, they generally utilized closing-price settlement procedures (i.e., P.M.-settlement). Due to concerns raised by the Commission on the impact of P.M.-settlement on market volatility and the operation of fair and orderly markets on the underlying cash market at or near the close of trading on expiration day, however, exchanges moved to A.M.-settlement for these products. As discussed in the recent

²⁰ See CBOE Regulatory Circular RG10-112.

approval of the NDXPM product,²¹ however, the Commission has recognized that these risks may be mitigated today by the enhanced closing procedures that are now employed by the primary equity markets. The Exchange believes that the concerns that led to the transition to A.M.-settlement for index derivatives have been largely mitigated today. Opening procedures in the 1990s were deemed acceptable to mitigate one-sided order flow driven by index option expiration. Nasdaq now has an automated closing cross that facilitates orderly closings by aggregating a large pool of liquidity, across a variety of order types, in a single venue. The Exchange believes that Nasdaq's closing procedures are well-equipped to mitigate imbalance pressure at the close. Furthermore, the Exchange believes that the proposed Pilot Program is designed to mitigate any potential concerns regarding P.M. settlement. Specifically, the Exchange believes that the Pilot Program will provide additional trading and hedging opportunities for investors while providing the Commission with data to monitor for and assess any potential for adverse market effects of allowing P.M.-settlement for NQX options, including on the underlying component stocks.

Finally, NQX options will be subject to the same rules that presently govern the trading of index options based on the Nasdaq-100, including sales practice rules, margin requirements, trading rules, and position and exercise limits. The Exchange therefore believes that the rules applicable to trading in NQX options are consistent with the protection of investors and the public interest. Furthermore, the Exchange represents that it has sufficient systems capacity and adequate surveillance procedures to handle trading in NQX options.

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

²¹ See supra note 7.

competition that is not necessary or appropriate in furtherance of the purposes of the Act. NQX options would be available for trading to all market participants. The proposed rule change will facilitate the listing and trading of a new option product that will enhance competition among market participants, to the benefit of investors and the marketplace. The listing of NQX will enhance competition by providing investors with an additional investment vehicle, in a fully-electronic trading environment, through which investors can gain and hedge exposure to the Nasdaq-100. Furthermore, this product could offer a competitive alternative to other existing investment products that seek to allow investors to gain broad market exposure. Finally, it is possible for other exchanges to develop or license the use of a new or different index to compete with the Nasdaq-100 and seek Commission approval to list and trade options on such an index.

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

No written comments were either solicited or received.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission shall: (a) by order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

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

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-ISE-2017-106 on the subject line.

Paper comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-ISE-2017-106. 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.

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-2017-106 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.²²

Eduardo A. Aleman
Assistant Secretary

²² 17 CFR 200.30-3(a)(12).