

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-82756; File No. SR-PEARL-2018-02)

February 21, 2018

Self-Regulatory Organizations; MIAX PEARL, LLC; Notice of Filing of a Proposed Rule Change to Adopt Rules Relating to Trading in Index Options

Pursuant to the provisions of 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 8, 2018, MIAX PEARL, LLC (“MIAX PEARL” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) a 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 adopt rules relating to trading in index options.

The text of the proposed rule change is available on the Exchange’s website at <http://www.miaxoptions.com/rule-filings/pearl> at MIAX PEARL’s principal office, 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 the most significant aspects of such statements.

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

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

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange is proposing to adopt new rules and amend existing rules to allow the Exchange to list and trade options on indices. The proposed rules include listing and maintenance criteria for options on underlying indices, rules on dissemination of index values, position and exercise limits for index options, exemptions from the limits, and terms of index options contracts. All of the proposed rules and changes to existing Exchange rules are based on existing rules of other options exchanges.<sup>3</sup> The proposed rules are intended to expand the Exchange’s capability to introduce and trade both existing and new and innovative index products on the MIAX PEARL System.<sup>4</sup>

Because the rules related to trading options on indices are product specific in many areas, the Exchange will need to file additional proposed rule changes with the Securities and Exchange Commission (“SEC” or “Commission”) when the Exchange identifies specific products.<sup>5</sup> For purposes of this proposed rule change, certain rules indicate that they apply to “Specified” indices. Proposed MIAX PEARL Rules 1800, 1801(n), 1804(a), 1807(a), 1809, and 1811 all contain provisions that are dependent upon the Exchange identifying specific index products in the rule. Accordingly, MIAX PEARL Rule 1800 states that where the rules in Chapter XVIII

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<sup>3</sup> See Miami International Securities Exchange, LLC (“MIAX Options”) Rules, Chapter XVIII, Index Options; Nasdaq ISE, (“Nasdaq ISE”) Rules, Chapter 20, Index Rules; Nasdaq PHLX (“Phlx”) Rules 1000A-1108A; and Cboe Options Exchange (“Cboe”) Rules, Chapter XXIV, Index Options.

<sup>4</sup> The term “System” means the automated trading system used by the Exchange for the trading of securities. See Exchange Rule 100.

<sup>5</sup> The Exchange proposes to separately file a request for an exemption from the rule filing requirements of Section 19(b) of the Act for changes to MIAX PEARL Chapter XVIII to the extent such rules are effected solely by virtue of a change to MIAX Options Chapter XVIII, including when MIAX Options identifies specific new products to list.

indicate that particular indices or requirements with respect to particular indices will be “Specified,” MIAX PEARL’s rules will be amended when MIAX Options<sup>6</sup> files a proposed rule change with the Commission pursuant to Section 19 of the Act<sup>7</sup> and Rule 19b-4<sup>8</sup> thereunder to specify such indices or requirements.

MIAX PEARL proposes to adopt new Chapter XVIII to the Exchange’s rules, which incorporate by reference Chapter XVIII of rules of the Exchange’s affiliate, MIAX Options.<sup>9</sup> In addition, MIAX PEARL proposes to amend Exchange Rule 504, Trading Halts. The Exchange notes that MIAX Options filed a substantially similar proposed rule change to adopt rules relating to trading index options (the “MIAX Options Rule Filing”), which was approved by the Commission on September 27, 2017.<sup>10</sup> The Exchange also notes that the MIAX Options Rule Filing proposed rule amendments to MIAX Options Rule 308, Exemptions from Position Limits; MIAX Options Rule 313, Other Restrictions on Options Transactions and Exercises; and MIAX Options Rule 700, Exercise of Option Contracts, all of which have already been incorporated by reference into MIAX PEARL’s rules, and thus are already applicable to MIAX PEARL

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<sup>6</sup> See id.

<sup>7</sup> 15 U.S.C. 78s.

<sup>8</sup> 17 CFR 240.19b-4.

<sup>9</sup> The Exchange notes that it is not amending MIAX PEARL Rule 503, Openings on the Exchange, because unlike MIAX Options Rule 503, MIAX PEARL Rule 503 does not distinguish between equity and index options. In addition, the Exchange notes that it is not amending MIAX PEARL Rule 603, Obligations of Market Makers, because unlike MIAX Options, MIAX PEARL does not use bid/ask differentials on the Exchange. Additionally, the Exchange is not amending MIAX PEARL Rule 527, Exchange Liability, because the amendment to the corresponding MIAX Options Rule was duplicative and the Exchange anticipates deleting the duplicative rule text in the future.

<sup>10</sup> See Securities Exchange Act Release No. 81739 (September 27, 2017), 82 FR 46111(October 3, 2017)(SR-MIAX-2017-39) (“Approval Order”).

members.<sup>11</sup> Each of the proposed rules to be incorporated by reference are discussed in detail below, but the text of the proposed rule change as set forth in Exhibit 5 of this rule filing specifies that the rules contained in MIAX Options Chapter XVIII are hereby incorporated by reference into these MIAX PEARL Rules, and are thus MIAX PEARL Rules and thereby applicable to MIAX PEARL Members.

Specifically, the rule provides: “[t]he rules contained in MIAX Options Exchange Chapter XVIII, as such rules may be in effect from time to time (the “Chapter XVIII Rules”), are hereby incorporated by reference into this MIAX PEARL Chapter XVIII, and are thus MIAX PEARL Rules and thereby applicable to MIAX PEARL Members. MIAX PEARL Members shall comply with the Chapter XVIII Rules as though such rules were fully-set forth herein. All defined terms, including any variations thereof, contained in Chapter XVIII Rules shall be read to refer to the MIAX PEARL related meaning of such term. Solely by way of example, and not in limitation or in exhaustion: the defined term “Exchange” in Chapter XVIII Rules shall be read to refer to MIAX PEARL; the defined term “Rule” in the Chapter XVIII Rules shall be read to refer to the MIAX PEARL Rule; and the defined term “Member” in the Chapter XVIII Rules shall be read to refer to the MIAX PEARL Member. Any reference to MIAX Options Rule 506(d) will be construed to reference corresponding MIAX PEARL Rule 506(e).”

#### Proposed Index Rules

The Exchange is proposing to adopt Chapter XVIII, Index Options, in the MIAX PEARL Rules. Proposed Rule 1800, Application of Index Rules, states that the Rules in proposed Chapter XVIII are applicable only to index options (options on indices of securities as defined below). The Rules in current Chapters I through XVII are also applicable to the options

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<sup>11</sup> Id.

provided for in proposed Chapter XVIII, unless such current Rules are specifically replaced or are supplemented by Rules in Chapter XVIII. Where the Rules in Chapter XVIII indicate that particular indices or requirements with respect to particular indices will be “Specified,” the Exchange shall file a proposed rule change with the Commission to specify such indices or requirements.<sup>12</sup>

### Definitions

Proposed MIAX PEARL Rule 1801, Definitions, contains the necessary definitions for index options trading.<sup>13</sup> Specifically, the following definitions will apply to index options on MIAX PEARL:

(a) The term "aggregate exercise price" means the exercise price of the options contract times the index multiplier.

(b) The term "American-style index option" means an option on an industry or market index that can be exercised on any business day prior to expiration, including the business day of expiration in the case of an option contract expiring on a business day.

(c) The term "A.M.-settled index option" means an index options contract for which the current index value at expiration shall be determined as provided in Rule 1809(a)(5).<sup>14</sup>

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<sup>12</sup> See supra note 5.

<sup>13</sup> The proposed Rule is based on Nasdaq ISE Rule 2001.

<sup>14</sup> The last day of trading for A.M.-settled index options shall be the business day preceding the business day of expiration, or, in the case of an option contract expiring on a day that is not a business day, the business day preceding the last day of trading in the underlying securities prior to the expiration date. The current index value at the expiration of an A.M.-settled index option shall be determined, for all purposes under these Rules and the Rules of the Clearing Corporation, on the last day of trading in the underlying securities prior to expiration, by reference to the reported level of such index as derived from first reported sale (opening) prices of the underlying securities on such day, except that: (i) in the event that the primary market for an underlying security does not open for trading on that day, the price of that security shall be determined, for the purposes of calculating the current index value at expiration, as set forth in Rule 1808(g), unless the current index

(d) The term "call" means an options contract under which the holder of the option has the right, in accordance with the terms of the option, to purchase from the Clearing Corporation the current index value times the index multiplier.

(e) The term "current index value" with respect to a particular index options contract means the level of the underlying index reported by the reporting authority for the index, or any multiple or fraction of such reported level specified by the Exchange. The current index value with respect to a reduced-value long term options contract is one-tenth of the current index value of the related index option. The "closing index value" shall be the last index value reported on a business day.

(f) The term "exercise price" means the specified price per unit at which the current index value may be purchased or sold upon the exercise of the option.

(g) The term "European-style index option" means an option on an industry or market index that can be exercised only on the business day of expiration, or, in the case of an option contract expiring on a day that is not a business day, the last business day prior to the day it expires.

(h) The term "Foreign Currency Index" means an index designed to track the performance of a basket of currencies, as provided in the table in Rule 1805A.

(i) The term "index multiplier" means the amount specified in the contract by which the current index value is to be multiplied to arrive at the value required to be delivered to the holder of a call or by the holder of a put upon valid exercise of the contract.

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value at expiration is fixed in accordance with the Rules and By-Laws of the Clearing Corporation; and (ii) in the event that the primary market for an underlying security is open for trading on that day, but that particular security does not open for trading on that day, the price of that security, for the purposes of calculating the current index value at expiration, shall be the last reported sale price of the security. See proposed Rule 1809(a)(5).

(j) The terms "industry index" and "narrow-based index" mean an index designed to be representative of a particular industry or a group of related industries or an index whose constituents are all headquartered within a single country.

(k) The term "market index" and "broad-based index" mean an index designed to be representative of a stock market as a whole or of a range of companies in unrelated industries.

(l) The term "put" means an options contract under which the holder of the option has the right, in accordance with the terms and provisions of the option, to sell to the Clearing Corporation the current index value times the index multiplier.

(m) The term "Quarterly Options Series" means, for the purposes of Chapter XVIII, a series in an index options class that is approved for listing and trading on the Exchange in which the series is opened for trading on any business day and that expires at the close of business on the last business day of a calendar quarter.

(n) The term "reporting authority" with respect to a particular index means the institution or reporting service designated by the Exchange as the official source for (1) calculating the level of the index from the reported prices of the underlying securities that are the basis of the index and (2) reporting such level. The reporting authority for each index approved for options trading on the Exchange shall be Specified (as provided in Rule 1800) in a table in Interpretations and Policies .01 to Rule 1801.

(o) The term "Short Term Option Series" means, for the purposes of Chapter XVIII, a series in an index option class that is approved for listing and trading on the Exchange in which the series is opened for trading on any Thursday or Friday that is a business day and that expires on the Friday of the following business week that is a business day. If a Friday is not a business

day, the series may be opened (or shall expire) on the first business day immediately prior to that Friday.

(p) The term "underlying security" or "underlying securities" with respect to an index options contract means any of the securities that are the basis for the calculation of the index.

### Listing Standards

Proposed Rule 1802, Designation of an Index, contains the general listing standards for index options. Proposed Rule 1802(a) provides that the component securities of an index underlying an index option contract need not meet the requirements of Rule 402.<sup>15</sup> Except as set forth in subparagraph (b) and (d) (as described below), the listing of a class of index options requires the filing of a proposed rule change to be approved by the Commission.

Proposed Rule 1802(b) describes the initial listing standards for a narrow-based index to be traded on the Exchange. The term "narrow based index" means an index designed to be representative of a particular industry or a group of related industries or an index whose constituents are all headquartered within a single country. Pursuant to proposed Rule 1802(b), the Exchange may trade options on a narrow-based index pursuant to Rule 19b-4(e) of the Act,<sup>16</sup> if each of the following conditions is satisfied:

- (1) The options are designated as A.M.-settled index options;
  - (2) The index is capitalization-weighted, price-weighted, equal dollar-weighted, or modified capitalization-weighted, and consists of 10 or more component securities;
  - (3) Each component security has a market capitalization of at least \$75 million,
- except that for each of the lowest weighted component securities in the index that in the

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<sup>15</sup> Exchange Rule 402, Criteria for Underlying Securities, sets forth the criteria that must be met by underlying equity securities with respect to which put or call option contracts are approved for listing and trading on the Exchange.

<sup>16</sup> 17 CFR 242.19b-4(e).



aggregate account for no more than ten percent (10%) of the weight of the index, the market capitalization is at least \$50 million;

(4) Trading volume of each component security has been at least 1,000,000 shares for each of the last six months, except that for each of the lowest weighted component securities in the index that in the aggregate account for no more than ten percent (10%) of the weight of the index, trading volume has been at least 500,000 shares for each of the last six months;

(5) In a capitalization-weighted index or a modified capitalization-weighted index, the lesser of the five highest weighted component securities in the index or the highest weighted component securities in the index that in the aggregate represent at least thirty percent (30%) of the total number of component securities in the index each have had an average monthly trading volume of at least 2,000,000 shares over the past six months;

(6) No single component security represents more than thirty percent (30%) of the weight of the index, and the five highest weighted component securities in the index do not in the aggregate account for more than fifty percent (50%) (sixty five percent (65%) for an index consisting of fewer than twenty five (25) component securities) of the weight of the index;

(7) Component securities that account for at least ninety percent (90%) of the weight of the index and at least eighty percent (80%) of the total number of component securities in the index satisfy the requirements of Rule 402 applicable to individual underlying securities;

(8) Each component security must be an “NMS stock” as defined in Rule 600 of Regulation NMS under the Act;<sup>17</sup>

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<sup>17</sup> 17 CFR 242.11Aa3-1.

(9) Non-U.S. component securities (stocks or ADRs) that are not subject to comprehensive surveillance agreements do not in the aggregate represent more than twenty percent (20%) of the weight of the index;

(10) The current index value is widely disseminated at least once every fifteen (15) seconds by the Options Price Reporting Authority (“OPRA”), the Consolidated Tape Association (“CTA”), the Nasdaq Index Dissemination Service (“NIDS”), or one or more major market data vendors during the time options on the index are traded on the Exchange;

(11) An equal dollar-weighted index will be rebalanced at least once every calendar quarter; and

(12) If an underlying index is maintained by a broker-dealer, the index is calculated by a third party who is not a broker-dealer, and the broker-dealer has erected an information barrier around its personnel who have access to information concerning changes in and adjustments to the index.

The above initial listing standards are the same as the initial listing standards currently in place on other exchanges.<sup>18</sup>

In addition to the initial listing standards, certain maintenance listing standards, listed below, apply to each class of index options originally listed pursuant to proposed Rule 1802(b).

Specifically, proposed Rule 1802(c) provides that the requirements stated in proposed Rules 1802(b)(1), (3), (6), (7), (8), (9), (10), (11) and (12) (set forth above) must continue to be satisfied, provided that the requirements stated in proposed Rule 1802(b)(6) below (relating to broad-based indices) must be satisfied only as of the first day of January and July in each year.

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<sup>18</sup> See, e.g., Miami International Securities Exchange (“MIAX Options”) Rule 1802(b); Nasdaq ISE, (“Nasdaq ISE”) Rule 2002(b); Nasdaq PHLX (“Phlx”) Rule 1009A(b); and Cboe Options Exchange, Inc. (“Cboe”) Rule 24.2(b).

In addition to maintaining the initial criteria in the proposed sub-paragraphs listed above, proposed Rule 1802(c) states that, in order for an index to remain listed on the Exchange:

(1) The total number of component securities in the index may not increase or decrease by more than 33 1/3 percent from the number of component securities in the index at the time of its initial listing, and in no event may be less than nine component securities;

(2) Trading volume of each component security in the index must be at least 500,000 shares for each of the last six months, except that for each of the lowest weighted component securities in the index that in the aggregate account for no more than ten percent (10%) of the weight of the index, trading volume must be at least 400,000 shares for each of the last six (6) months; and

(3) In a capitalization-weighted index or a modified capitalization-weighted index, the lesser of the five highest weighted component securities in the index or the highest weighted component securities in the index that in the aggregate represent at least thirty percent (30%) of the total number of stocks in the index each have had an average monthly trading volume of at least 1,000,000 shares over the past six months. In the event a class of index options listed on the Exchange fails to satisfy the maintenance listing standards set forth herein, the Exchange shall not open for trading any additional series of options of that class unless such failure is determined by the Exchange not to be significant and the SEC concurs in that determination, or unless the continued listing of that class of index options has been approved by the SEC under Section 19(b) (2) of the Act.<sup>19</sup>

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<sup>19</sup> 15 U.S.C. 78s(b)(2).

These maintenance listing standards are the same as the maintenance standards currently in place on other exchanges.<sup>20</sup>

Proposed Rule 1802(d) states that the Exchange may trade options on a broad-based index<sup>21</sup> if each of the following conditions is satisfied:

- (1) The index is broad-based, as defined in Rule 1801(k);
- (2) Options on the index are designated as A.M.-settled;
- (3) The index is capitalization-weighted, modified capitalization-weighted, price-weighted, or equal dollar-weighted;
- (4) The index consists of 50 or more component securities;
- (5) Component securities that account for at least ninety-five percent (95%) of the weight of the index have a market capitalization of at least \$75 million, except that component securities that account for at least sixty-five percent (65%) of the weight of the index have a market capitalization of at least \$100 million;
- (6) Component securities that account for at least eighty percent (80%) of the weight of the index satisfy the requirements of Rule 402 applicable to individual underlying securities;
- (7) Each component security that accounts for at least one percent (1%) of the weight of the index has an average daily trading volume of at least 90,000 shares during the last six month period;

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<sup>20</sup> See, e.g., MIAX Options Rule 1802(c); Nasdaq ISE Rule 2002(c); Nasdaq Phlx Rule 1009A(c); and Cboe Rule 24.2(c).

<sup>21</sup> The term "market index" and "broad-based index" mean an index designed to be representative of a stock market as a whole or of a range of companies in unrelated industries. See proposed Rule 1801(k).

(8) No single component security accounts for more than ten percent (10%) of the weight of the index, and the five highest weighted component securities in the index do not, in the aggregate, account for more than thirty-three percent (33%) of the weight of the index;

(9) Each component security must be an “NMS stock” as defined in Rule 600 of Regulation NMS under the Act;<sup>22</sup>

(10) Non-U.S. component securities (stocks or ADRs) that are not subject to comprehensive surveillance agreements do not, in the aggregate, represent more than twenty percent (20%) of the weight of the index;

(11) The current index value is widely disseminated at least once every fifteen (15) seconds by the Options Price Reporting Authority (“OPRA”), the Consolidated Tape Association (“CTA”), the Nasdaq Index Dissemination Service (“NIDS”), or one or more major market data vendors during the time options on the index are traded on the Exchange;

(12) The Exchange reasonably believes it has adequate system capacity to support the trading of options on the index, based on a calculation of the Exchange’s current ISCA allocation and the number of new messages per second expected to be generated by options on such index;

(13) An equal dollar-weighted index is rebalanced at least once every calendar quarter;

(14) If an index is maintained by a broker-dealer, the index is calculated by a third-party who is not a broker-dealer, and the broker-dealer has erected an informational barrier around its personnel who have access to information concerning changes in, and adjustments to, the index; and

(15) The Exchange has written surveillance procedures in place with respect to surveillance of trading of options on the index.

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<sup>22</sup> 17 CFR 242.600.

These initial listing standards are the same as the initial listing standards for broad-based indices currently in place on other exchanges.<sup>23</sup>

Proposed Rule 1802(e) sets forth the maintenance listing standards for broad-based indices. Specifically, the following maintenance listing standards shall apply to each class of index options originally listed pursuant to proposed Rule 1802(d).

First, the requirements set forth in the proposed initial listing standards set forth in proposed Rules 1802(d)(1) - (d)(3), and proposed Rules 1802(d)(9) - (d)(15) must continue to be satisfied. The requirements set forth in proposed Rules 1802(d)(5) - (d)(8) must be satisfied only as of the first day of January and July in each year.

Additionally, for broad-based indices, the total number of component securities in the index may not increase or decrease by more than ten percent (10%) from the number of component securities in the index at the time of its initial listing.

Finally, proposed Rule 1802(e) states that, in the event a class of index options listed on the Exchange fails to satisfy the maintenance listing standards set forth in the proposed Rule, the Exchange shall not open for trading any additional series of options of that class unless the continued listing of that class of index options has been approved by the Commission under Section 19(b)(2) of the Act.<sup>24</sup>

These maintenance listing standards are the same as the maintenance standards for broad-based indices that are currently in place on other exchanges.<sup>25</sup>

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<sup>23</sup> See, e.g., MIAX Options Rule 1802(d); Nasdaq ISE Rule 2002(d); Nasdaq Phlx Rule 1009A(d); and Cboe Rule 24.2(f).

<sup>24</sup> 15 U.S.C 78s(b)(2).

<sup>25</sup> See, e.g., MIAX Options Rule 1802(e); Nasdaq ISE Rule 2002(e); Nasdaq Phlx Rule 1009A(e); and Cboe Rule 24.2(g).

The Exchange believes that the requirements in the proposed listing standards regarding, among other things, the minimum market capitalization, trading volume, and relative weightings of an underlying index's component stocks are designed to ensure that the markets for the index's component stocks are adequately capitalized and sufficiently liquid, and that no one stock dominates the index. The Exchange believes that these requirements minimize the potential for manipulating the underlying index.

The Exchange further believes that the requirement in proposed Rule 1802(b)(10) (with respect to narrow-based index options) that the current underlying index value will be reported at least once every fifteen (15) seconds during the time the index options are traded on the Exchange, and the requirement in proposed Rule 1802(d)(11) (with respect to broad-based index options) that the current index value be widely disseminated at least once every fifteen (15) seconds by the OPRA, CTA/CQ, NIDS or by one or more major market data vendors during the time an index option trades on MIAX PEARL should provide transparency with respect to current index values and contribute to the transparency of the market for index options. In addition, the Exchange believes that the requirement in proposed Rule 1802(d)(2) that an index option be A.M.-settled, rather than on closing prices, should help to reduce the potential impact of expiring index options on the market for the index's component securities.

Proposed Rule 1803, Dissemination of Information, requires the dissemination of index values as a condition to the trading of options on an index. The proposed rule includes the requirement that the Exchange disseminate, or assure that the current index value is disseminated, after the close of business and from time-to-time on days on which transactions in index options are made on the Exchange. The proposed rule also requires the Exchange to maintain, in files available to the public, information identifying the components whose prices

are the basis for calculation of the index and the method used to determine the current index value.<sup>26</sup>

The Exchange is proposing to adopt Rules 1804 through 1807 relating to position limits, exemptions from position limits, and exercise limits in index options. These proposed rules contain the standard position limit and exercise limits for Broad-Based, Industry (narrow-based) and Foreign Currency index options, as well as exemption standards and the procedures for requesting exemptions from those proposed rules.<sup>27</sup>

Proposed Rule 1804, Position Limits for Broad-Based Index Options, states that Exchange Rule 307 generally shall govern position limits for broad-based index options, as modified by proposed Rule 1804. Specifically, the proposed rule states that there may be no position limit for certain Specified (as provided in Rule 1800)<sup>28</sup> broad-based index options contracts. Except as otherwise indicated below, the position limit for a broad-based index option shall be 25,000 contracts on the same side of the market. Reduced-value options<sup>29</sup> on broad-based security indexes for which full-value options have no position and exercise limits will similarly have no position and exercise limits. All other broad-based index options contracts shall be subject to a contract limitation fixed by the Exchange, which shall not be larger than the limits provided in the chart below.

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<sup>26</sup> This proposed Rule is substantially similar to Nasdaq ISE Rule 2003 and Cboe Rule 24.3.

<sup>27</sup> These proposed Rules are based on Nasdaq ISE Rule 2006.

<sup>28</sup> See supra note 5.

<sup>29</sup> See proposed Rule 1809(b)(2).



<b>Broad-Based Underlying Index</b>	<b>Standard Limit (on the same side of the market)</b>	<b>Restrictions</b>
To be Specified	To be Specified	To be Specified

Proposed Rules 1804(b) through (d) describe situations in which index option contracts will, or will not, be aggregated for purposes of establishing the number of contracts in a position. Specifically, proposed Rule 1804(b) states that that index options contracts shall not be aggregated with options contracts on any stocks whose prices are the basis for calculation of the index. Proposed Rule 1804(c) states that positions in reduced-value index options shall be aggregated with positions in full-value indices. For such purposes, ten reduced-value contracts shall equal one contract. Finally, proposed Rule 1804(d) states that positions in Short Term Option Series and Quarterly Options Series shall be aggregated with positions in options contracts on the same index.<sup>30</sup>

Proposed Rule 1805, Position Limits for Industry Index Options, states that Rule 307 generally shall govern position limits for industry index<sup>31</sup> options, as modified by proposed Rule 1805.

Proposed Rule 1805(a) sets forth position limits for industry index options. These position limits, once established by the Exchange, must be reviewed and determined on a semi-annual basis, as described below.

The specific position limits applicable to an industry index are:

(i) 18,000 contracts if the Exchange determines, at the time of a review conducted as described below, that any single underlying stock accounted, on average, for thirty

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<sup>30</sup> This is substantially similar to Nasdaq ISE Rule 2004 and Cboe Rule 24.4.

<sup>31</sup> For purposes of this proposed rule change and these proposed rules, the term “industry index” has the same meaning as the term “narrow-based index.”

percent (30%) or more of the index value during the thirty (30)-day period immediately preceding the review; or

(ii) 24,000 contracts if the Exchange determines, at the time of a review conducted as set forth below, that any single underlying stock accounted, on average, for twenty percent (20%) or more of the index value or that any five (5) underlying stocks together accounted, on average, for more than fifty percent (50%) of the index value, but that no single stock in the group accounted, on average, for thirty percent (30%) or more of the index value, during the thirty (30)-day period immediately preceding the review; or

(iii) 31,500 contracts if the Exchange determines that the conditions specified above which would require the establishment of a lower limit have not occurred.

Proposed Rule 1805(a)(2) requires the Exchange make the determinations of these specific position limits described above with respect to options on each industry index, first at the commencement of trading of such options on the Exchange and thereafter review the determination semi-annually on January 1 and July 1.

Proposed Rule 1805(a)(3) describes the procedures to be taken by the Exchange at the time of each semi-annual review. Specifically, if the Exchange determines, at the time of the semi-annual review, that the position limit in effect with respect to options on a particular industry index is lower than the maximum position limit permitted by the criteria set forth in Rule 1805(a)(1), the Exchange may effect an appropriate position limit increase immediately.<sup>32</sup>

Conversely, if the Exchange determines, at the time of a semi-annual review, that the position limit in effect with respect to options on a particular industry index exceeds the

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<sup>32</sup> For example, if the conditions specified in proposed Rule 1805(a)(ii) are determined to exist which would allow a position limit of 24,000 contracts and the current position limit for the option, based upon the previous review, has been established as 18,000 contracts, the Exchange may effect a position limit increase to 24,000 contracts immediately.

maximum position limit permitted by the criteria set forth in proposed Rule 1805(a)(1), the Exchange shall reduce the position limit applicable to such options to a level consistent with such criteria. Such a reduction would not become effective until after the expiration date of the most distantly expiring options series relating to the industry index that is open for trading on the date of the review, and such a reduction shall not become effective if the Exchange determines, at the next semi-annual review, that the existing position limit applicable to such options is consistent with the criteria set forth in proposed Rule 1805(a)(1).<sup>33</sup> The purpose of this provision is to protect investors with open positions as of the date of the review from inadvertently violating the new, reduced position limit. Additionally, an Exchange determination (prior to the effectiveness of the new, lower position limit due to remaining unexpired series) that the criteria permitting the higher position limit again exist obviates the need for the lower position limit and the lower position limit will not take effect.

Proposed Rules 1805(b) – (d) describe situations in which industry index option contracts will, or will not, be aggregated for purposes of establishing the number of contracts in a position. Just as with broad-based index options,<sup>34</sup> proposed Rules 1805(b) – (d) state that index options contracts shall not be aggregated with options contracts on any stocks whose prices are the basis for calculation of the index. Positions in reduced-value index options shall be aggregated with positions in full-value index options. For such purposes, ten (10) reduced-value options shall equal one (1) full-value contract. Positions in Short Term Option Series and Quarterly Options Series shall be aggregated with positions in options contracts on the same index.

Proposed Rule 1805A, Position Limits for Foreign Currency Index Options, includes a table to be completed by the Exchange upon the Exchange's determination to list and trade

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<sup>33</sup> The proposed Rule is virtually identical to Cboe Rule 24.4A.

<sup>34</sup> See proposed Rules 1804(b)-(d).

options overlying a Foreign Currency Index (subject to the Commission’s approval of a proposed rule change). Under the proposed rule, option contracts on a Foreign Currency Index shall be subject to the position limits described in the table below.

<b>Foreign Currency Index</b>	<b>Standard Limit (on the same side of the market)</b>	<b>Restrictions</b>
To be Specified	To be Specified	To be Specified

Proposed Rule 1806, Exemptions from Position Limits, describes the broad-based index hedge exemption, the industry index hedge exemption, the application on the Exchange of exemptions granted by other options exchanges, and the delta-based index hedge exemption.

Proposed Rule 1806(a) describes the broad-based index hedge exemption. The broad-based index hedge exemption is in addition to the other exemptions available under Exchange Rules, Interpretations and Policies.<sup>35</sup> The proposed rule sets forth the procedures and criteria which must be satisfied to qualify for a broad-based index hedge exemption.

First, proposed Rule 1806(a)(1) states that the account in which the exempt options positions are held ("hedge exemption account") must have received prior Exchange approval for the hedge exemption specifying the maximum number of contracts that may be exempt under the proposed Rule. The hedge exemption account must have provided all information required on Exchange-approved forms and must have kept such information current. Exchange approval may be granted on the basis of verbal representations, in which event the hedge exemption account shall within two business days, or such other time period designated by the Exchange, furnish the Exchange with appropriate forms and documentation substantiating the basis for the exemption. The hedge exemption account may apply from time to time for an increase in the maximum number of contracts exempt from the position limits.

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<sup>35</sup> See, e.g., Exchange Rule 308.

Proposed Rule 1806(a)(2) states that a hedge exemption account that is not carried by a Member must be carried by a member of a self-regulatory organization participating in the Intermarket Surveillance Group (“ISG”), which is comprised of an international group of exchanges, market centers, and market regulators.<sup>36</sup>

Proposed Rule 1806(a)(3) requires that the hedge exemption account maintain a qualified portfolio, or will effect transactions necessary to obtain a qualified portfolio concurrent with or at or about the same time as the execution of the exempt options positions, of:

(i) a net long or short position in common stocks in at least four industry groups and contains at least twenty (20) stocks, none of which accounts for more than fifteen percent (15%) of the value of the portfolio or in securities readily convertible, and additionally in the case of convertible bonds economically convertible, into common stocks which would comprise a portfolio; or

(ii) a net long or short position in index futures contracts or in options on index futures contracts, or long or short positions in index options or index warrants, for which the underlying index is included in the same margin or cross-margin product group cleared at the Clearing Corporation as the index options class to which the hedge exemption applies.

To remain qualified, a portfolio must at all times meet these standards notwithstanding trading activity.

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<sup>36</sup> The purpose of the ISG is to provide a framework for the sharing of information and the coordination of regulatory efforts among exchanges trading securities and related products to address potential intermarket manipulations and trading abuses. The ISG plays a crucial role in information sharing among markets that trade securities, options on securities, security futures products, and futures and options on broad-based security indexes. A list identifying the current ISG members is available at <https://www.isgportal.org/isgPortal/public/members.htm>.

Proposed Rule 1806(a)(4) contains the requirement that, in order to qualify for the broad-based exemption, the exemption must apply to positions in broad-based index options dealt in on the Exchange and is applicable to the unhedged value of the qualified portfolio. The unhedged value will be determined as follows:

(i) the values of the net long or short positions of all qualifying products in the portfolio are totaled;

(ii) for positions in excess of the standard limit, the underlying market value (A) of any economically equivalent opposite side of the market calls and puts in broad-based index options, and (B) of any opposite side of the market positions in stock index futures, options on stock index futures, and any economically equivalent opposite side of the market positions, assuming no other hedges for these contracts exist, is subtracted from the qualified portfolio; and

(iii) the market value of the resulting unhedged portfolio is equated to the appropriate number of exempt contracts as follows: the unhedged qualified portfolio is divided by the correspondent closing index value and the quotient is then divided by the index multiplier or 100.

Proposed Rule 1806(a)(5) states that positions in broad-based index options that are traded on the Exchange are exempt from the standard limits to the extent specified in the table below.

<b>Broad-Based Index Option Type</b>	<b>Broad-Based Index Hedge Exemption (in addition to standard limit)</b>
Broad-based indexes other than for those that do not have any position limits	75,000

Proposed Rule 1806(a)(6) lists the types of transactions that are available for hedging. Specifically, only the following qualified hedging transactions and positions are eligible for purposes of hedging a qualified portfolio (*i.e.* stocks, futures, options and warrants) pursuant to the proposed Rule:

- (i) Long put(s) used to hedge the holdings of a qualified portfolio;
- (ii) Long call(s) used to hedge a short position in a qualified portfolio;
- (iii) Short call(s) used to hedge the holdings of a qualified portfolio; and
- (iv) Short put(s) used to hedge a short position in a qualified portfolio.

Proposed Rule 1806(a)(6) then identifies the following strategies, which may be effected only in conjunction with a qualified stock portfolio for non-P.M. settled, European style index options only:

(v) A short call position accompanied by long put(s), where the short call(s) expires with the long put(s), and the strike price of the short call(s) equals or exceeds the strike price of the long put(s) (a “collar”). Neither side of the collar transaction can be in-the-money at the time the position is established. For purposes of determining compliance with Rule 306 and proposed Rule 1806, a collar position will be treated as one contract;

(vi) A long put position coupled with a short put position overlying the same broad-based index and having an equivalent underlying aggregate index value, where the short put(s) expires with the long put(s), and the strike price of the long put(s) exceeds the strike price of the short put(s) (a “debit put spread position”); and

(vii) A short call position accompanied by a debit put spread position, where the short call(s) expires with the puts and the strike price of the short call(s) equals or exceeds the strike price of the long put(s). Neither side of the short call, long put transaction can be in-the-money at

the time the position is established. For purposes of determining compliance with Rule 307 and this Rule 1806, the short call and long put positions will be treated as one contract.

Proposed Rule 1806(a)(7) describes certain permitted and prohibited activities for hedge exemption accounts. Specifically, the proposed Rule states that the hedge exemption account shall:

(i) liquidate and establish options, stock positions, their equivalent or other qualified portfolio products in an orderly fashion; not initiate or liquidate positions in a manner calculated to cause unreasonable price fluctuations or unwarranted price changes; and not initiate or liquidate a stock position or its equivalent with an equivalent index options position with a view toward taking advantage of any differential in price between a group of securities and an overlying stock index option;

(ii) liquidate any options prior to or contemporaneously with a decrease in the hedged value of the qualified portfolio which options would thereby be rendered excessive; and

(iii) promptly notify the Exchange of any material change in the qualified portfolio which materially affects the unhedged value of the qualified portfolio.

Proposed Rules 1806(a)(8) - (12) contain several regulatory requirements for hedge exemption accounts. Specifically, the proposed Rules state that if an exemption is granted, it will be effective at the time the decision is communicated. Retroactive exemptions will not be granted. The proposed rules also require that the hedge exemption account shall promptly provide to the Exchange any information requested concerning the qualified portfolio. Positions included in a qualified portfolio that serve to secure an index hedge exemption may not also be used to secure any other position limit exemption granted by the Exchange or any other self-regulatory organization or futures contract market. Any Member that maintains a broad-based



index options position in such Member's own account or in a customer account, and has reason to believe that such position is in excess of the applicable limit, shall promptly take the action necessary to bring the position into compliance. Failure to abide by this provision shall be deemed to be a violation of Rules 307 and Rule 1806 by the Member. Finally, violation of any of the provisions of the proposed rule, absent reasonable justification or excuse, shall result in withdrawal of the index hedge exemption and may form the basis for subsequent denial of an application for an index hedge exemption.

Proposed Rule 1806(b) describes the Industry Index Hedge Exemption. The industry (narrow-based) index hedge exemption is in addition to the other exemptions available under Exchange Rules, Interpretations and Policies, and may not exceed twice the standard limit established under Rule 1805. Industry index options positions may be exempt from established position limits for each options contract "hedged" by an equivalent dollar amount of the underlying component securities or securities convertible into such components; provided that, in applying such hedge, each options position to be exempted is hedged by a position in at least seventy-five percent (75%) of the number of component securities underlying the index. In addition, the underlying value of the options position may not exceed the value of the underlying portfolio. The value of the underlying portfolio is: (1) the total market value of the net stock position; and (2) for positions in excess of the standard limit, subtract the underlying market value of: (i) any offsetting calls and puts in the respective index option; (ii) any offsetting positions in related stock index futures or options; and (iii) any economically equivalent positions (assuming no other hedges for these contracts exist). The following procedures and criteria must be satisfied to qualify for an industry index hedge exemption:

(1) The hedge exemption account must have received prior Exchange approval for the hedge exemption specifying the maximum number of contracts that may be exempt under this Interpretation. The hedge exemption account must have provided all information required on Exchange-approved forms and must have kept such information current. Exchange approval may be granted on the basis of verbal representations, in which event the hedge exemption account shall within two business days, or such other time period designated by the Exchange, furnish the Exchange with appropriate forms and documentation substantiating the basis for the exemption. The hedge exemption account may apply from time to time for an increase in the maximum number of contracts exempt from the position limits.

(2) A hedge exemption account that is not carried by a Member must be carried by a member of a self-regulatory organization participating in the Intermarket Surveillance Group.

(3) The hedge exemption account shall liquidate and establish options, stock positions, or economically equivalent positions in an orderly fashion; shall not initiate or liquidate positions in a manner calculated to cause unreasonable price fluctuations or unwarranted price changes; and shall not initiate or liquidate a stock position or its equivalent with an equivalent index options position with a view toward taking advantage of any differential in price between a group of securities and an overlying stock index option. The hedge exemption account shall liquidate any options prior to or contemporaneously with a decrease in the hedged value of the portfolio which options would thereby be rendered excessive. The hedge exemption account shall promptly notify the Exchange of any change in the portfolio which materially affects the unhedged value of the portfolio.

(4) If an exemption is granted, it will be effective at the time the decision is communicated. Retroactive exemptions will not be granted.

(5) The hedge exemption account shall promptly provide to the Exchange any information requested concerning the portfolio.

(6) Positions included in a portfolio that serve to secure an index hedge exemption may not also be used to secure any other position limit exemption granted by the Exchange or any other self-regulatory organization or futures contract market.

(7) Any Member that maintains an industry index options position in such Member's own account or in a customer account, and has reason to believe that such position is in excess of the applicable limit, shall promptly take the action necessary to bring the position into compliance. Failure to abide by this provision shall be deemed to be a violation of Rule 307 and proposed Rule 1806 by the Member.

(8) Violation of any of the provisions of proposed Rule 1806, absent reasonable justification or excuse, shall result in withdrawal of the index hedge exemption and may form the basis for subsequent denial of an application for an index hedge exemption hereunder.

Proposed Rule 1806(c), Exemptions Granted by Other Options Exchanges, states that a Member may rely upon any available exemptions from applicable position limits granted from time to time by another options exchange for any options contract traded on the Exchange provided that such Member:

(1) provides the Exchange with a copy of any written exemption issued by another options exchange or a written description of any exemption issued by another options exchange other than in writing containing sufficient detail for Exchange regulatory staff to verify the validity of that exemption with the issuing options exchange, and

(2) fulfills all conditions precedent for such exemption and complies at all times with the requirements of such exemption with respect to the Member's trading on the Exchange.

Proposed Rule 1806(d), Delta-Based Index Hedge Exemption, describes the Delta-Based Index Hedge Exemption as in addition to the standard limit and other exemptions available under Exchange rules. The proposed rule states that an index option position of a Member or non-Member affiliate of a Member that is delta neutral shall be exempt from established position limits as prescribed under Rules 1804 and 1805, subject to the following:

(1) The term “delta neutral” refers to an index option position that is hedged, in accordance with a permitted pricing model, by a position in one or more correlated instruments, for the purpose of offsetting the risk that the value of the option position will change with incremental changes in the value of the underlying index. The term “correlated instruments” means securities and/or other instruments that track the performance of or are based on the same underlying index as the index underlying the option position (but not including baskets of securities).

(2) An index option position that is not delta neutral shall be subject to position limits in accordance with proposed Rules 1804 and 1805 (subject to the availability of other position limit exemptions). Only the options contract equivalent of the net delta of such position shall be subject to the appropriate position limit. The “options contract equivalent of the net delta” is the net delta divided by units of trade that equate to one option contract on a delta basis. The term “net delta” means, at any time, the number of shares and/or other units of trade (either long or short) required to offset the risk that the value of an index option position will change with incremental changes in the value of the underlying index, as determined in accordance with a permitted pricing model.

(3) A “permitted pricing model” shall have the meaning as defined in Rule 308(a)(7)(iii).<sup>37</sup>

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A “permitted pricing model” means: (A) A pricing model maintained and operated by the Clearing Corporation (“OCC Model”); (B) A pricing model maintained and used by a Member subject to consolidated supervision by the SEC pursuant to Appendix E of SEC Rule 15c3-1, or by an affiliate that is part of such Member’s consolidated supervised holding company group, in accordance with its internal risk management control system and consistent with the requirements of Appendices E or G, as applicable, to SEC Rule 15c3-1 and SEC Rule 15c3-4 under the Exchange Act, as amended from time to time, in connection with the calculation of risk-based deductions from capital or capital allowances for market risk thereunder, provided that the Member or affiliate of a Member relying on this exemption in connection with the use of such model is an entity that is part of such Member’s consolidated supervised holding company group; (C) A pricing model maintained and used by a financial holding company or a company treated as a financial holding company under the Bank Holding Company Act of 1956, or by an affiliate that is part of either such company’s consolidated supervised holding company group, in accordance with its internal risk management control system and consistent with: 1. the requirements of the Board of Governors of the Federal Reserve System, as amended from time to time, in connection with the calculation of risk based adjustments to capital for market risk under capital requirements of the Board of Governors of the Federal Reserve System, provided that the Member or affiliate of a Member relying on this exemption in connection with the use of such model is an entity that is part of such company’s consolidated supervised holding company group; or 2. the standards published by the Basel Committee on Banking Supervision, as amended from time to time and as implemented by such company’s principal regulator, in connection with the calculation of risk-based deductions or adjustments to or allowances for the market risk capital requirements of such principal regulator applicable to such company – where “principal regulator” means a member of the Basel Committee on Banking Supervision that is the home country consolidated supervisor of such company – provided that the Member or affiliate of a Member relying on this exemption in connection with the use of such model is an entity that is part of such company’s consolidated supervised holding company group. (D) A pricing model maintained and used by an OTC derivatives dealer registered with the SEC pursuant to SEC Rule 15c3-1(a)(5) in accordance with its internal risk management control system and consistent with the requirements of Appendix F to SEC Rule 15c3-1 and SEC Rule 15c3-4 under the Exchange Act, as amended from time to time, in connection with the calculation of risk-based deductions from capital for market risk thereunder, provided that only such OTC derivatives dealer and no other affiliated entity (including a Member) may rely on this subparagraph (D); or (E) A pricing model used by a national bank under the National Bank Act maintained and used in accordance with its internal risk management control system and consistent with the requirements of the Office of the Comptroller of the Currency, as amended from time to time, in connection with the calculation of risk based adjustments to capital for market risk under capital requirements of the Office of the Comptroller of the Currency,

Proposed Rule 1806(d)(4), Effect on Aggregation of Accounts, states that (i) Members and non-Member affiliates who rely on this exemption must ensure that the permitted pricing model is applied to all positions in correlated instruments that are owned or controlled by such Member or non-Member affiliate.

Notwithstanding subparagraph (i), above, the net delta of an option position held by an entity entitled to rely on this exemption, or by a separate and distinct trading unit of such entity, may be calculated without regard to positions in correlated instruments held by an affiliated entity or by another trading unit within the same entity, provided that:

(A) the entity demonstrates to the Exchange's satisfaction that no control relationship, as defined in Rule 307(f), exists between such affiliates or trading units; and

(B) the entity has provided (by the Member carrying the account as applicable) the Exchange written notice in advance that it intends to be considered separate and distinct from any affiliate or, as applicable, which trading units within the entity are to be considered separate and distinct from each other for purposes of this exemption.

Proposed Rule 1806(d)(4)(iii) states that, notwithstanding subparagraphs (i) and (ii) of proposed Rule 1806(d)(4), a Member or non-Member affiliate who relies on this exemption shall designate, by prior written notice to the Exchange (to be obtained and provided by the Member carrying the account as applicable), each trading unit or entity whose option positions are required under Exchange Rules to be aggregated with the option positions of such Member or non-Member affiliate that is relying on this exemption for purposes of compliance with Exchange position limits or exercise limits. In any such case: (A) the permitted pricing model shall be applied, for purposes of calculating such Member's or affiliate's net delta, only to the

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provided that only such national bank and no other affiliated entity (including a Member) may rely on this subparagraph (E).

positions in correlated instruments owned and controlled by those entities and trading units who are relying on this exemption; and (B) the net delta of the positions owned or controlled by the entities and trading units who are relying on this exemption shall be aggregated with the non-exempt option positions of all other entities and trading units whose options positions are required under Exchange Rules to be aggregated with the option positions of such Member or affiliate.

Proposed Rule 1806(d)(5) describes the obligations of Members seeking the Delta Hedge Exemption. First, a Member that relies on this exemption for a proprietary index options position: (A) must provide a written certification to the Exchange that it is using a permitted pricing model as defined above, and (B) by such reliance authorizes any other person carrying for such Member an account including, or with whom such Member has entered into, a position in a correlated instrument to provide to the Exchange or the Clearing Corporation such information regarding such account or position as the Exchange or Clearing Corporation may request as part of the Exchange's confirmation or verification of the accuracy of any net delta calculation under this exemption. The index option positions of a non-Member relying on this exemption must be carried by a Member with which it is affiliated.

Proposed Rule 1806(d)(5)(iii) requires that a Member carrying an account that includes an index option position for a non-Member affiliate that intends to rely on the Delta-Based Hedge Exemption must obtain from such non-Member affiliate and must provide to the Exchange: (A) a written certification to the Exchange that the non-Member affiliate is using a permitted pricing model as described above; and (B) a written statement confirming that such non-Member affiliate: (1) is relying on this exemption; (2) will use only a permitted pricing model for purposes of calculating the net delta of its option positions for purposes of this

exemption; (3) will promptly notify the Member if it ceases to rely on this exemption; (4) authorizes the Member to provide to the Exchange or the Clearing Corporation such information regarding positions of the non-Member affiliate as the Exchange or Clearing Corporation may request as part of the Exchange's confirmation or verification of the accuracy of any net delta calculation under this exemption; and (5) if the non-Member affiliate is using the Clearing Corporation Model, has duly executed and delivered to the Member such documents as the Exchange may require to be executed and delivered to the Exchange as a condition to reliance on the exemption.

Proposed Rule 1806(d)(6) requires each Member (other than an Exchange market maker using the Clearing Corporation Model) that holds or carries an account that relies on the Delta-Based Hedge Exemption shall report, in accordance with Exchange Rule 310,<sup>38</sup> all index option

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<sup>38</sup> Each Member is required under Exchange Rule 310, Reports Related to Position Limits, to file with the Exchange the name, address and social security or tax identification number of any customer, as well as any Member, any general or special partner of the Member, any officer or director of the Member or any participant, as such, in any joint, group or syndicate account with the Member or with any partner, officer or director thereof, who, on the previous business day held aggregate long or short positions of 200 or more option contracts of any single class of options traded on the Exchange. The report shall indicate for each such class of option contracts the number of option contracts comprising each such position and, in case of short positions, whether covered or uncovered. (b) Electronic Exchange Members that maintain an end of day position in excess of 10,000 non-FLEX equity option contracts on the same side of the market on behalf of its own account or for the account of a customer, shall report whether such position is hedged and provide documentation as to how such position is hedged. This report is required at the time the subject account exceeds the 10,000 contract threshold and thereafter, for customer accounts, when the position increases by 2,500 contracts and for proprietary accounts when the position increases by 5,000 contracts. (c) In addition to the reports required by paragraph (a) and (b) of this Rule, each Member shall report promptly to the Exchange any instance in which the Member has reason to believe that a person included in paragraph (a), acting alone or in concert with others, has exceeded or is attempting to exceed the position limits established pursuant to Rule 307. Interpretations and Policies: .01 For purposes of calculating the aggregate long or short position under paragraph (a) above, Members shall combine (i) long positions in put



positions (including those that are delta neutral) that are reportable thereunder. Each such Member on its own behalf or on behalf of a designated aggregation unit pursuant to Rule 1806(d)(4) shall also report, in accordance with Exchange Rule 310 for each such account that holds an index option position subject to the Delta-Based Hedge Exemption in excess of the levels specified in Rules 1804 and 1805, the net delta and the options contract equivalent of the net delta of such position.

Finally, proposed Rule 1806(d)(7) requires that each Member relying on the Delta-Based Hedge Exemption shall: (i) retain, and undertake reasonable efforts to ensure that any non-Member affiliate of the Member relying on this exemption retains, a list of the options, securities and other instruments underlying each option position net delta calculation reported to the Exchange hereunder, and (ii) produce such information to the Exchange upon request.

The proposed Rules relating to position limits and exemptions from position limits are based on, and substantially similar to, rules that are currently in place on other exchanges.<sup>39</sup>

Proposed Rule 1808, Trading Sessions, provides that index options will trade between the hours of 9:30 a.m. and 4:15 p.m. Eastern time, the same as on other exchanges. The proposed rule also contains procedures for trading rotations, as well as trading halts and suspensions.

Specifically, proposed Rule 1808(a) states that, except as otherwise provided in this Rule or under unusual conditions as may be determined by the Exchange, (i) transactions in index options may be effected on the Exchange between the hours of 9:30 a.m. and 4:15 p.m. Eastern time, and (ii) transactions in options on a Foreign Currency Index may be effected on the

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options with short positions in call options, and (ii) short positions in put options with long positions in call options. See Exchange Rule 310.

<sup>39</sup> See, e.g., Nasdaq ISE Rule 2006; Cboe Rule 24.4, Interpretations and Policies .01, .05, and Rule 24.4A; and Nasdaq Phlx Rule 1001A and Interpretations and Policies .01 - .04 thereto.

Exchange between the hours of 7:30 a.m. and 4:15 p.m. Eastern time. With respect to options on foreign indexes, the Exchange shall determine the days and hours of business. The proposed Rule and the various enumerated times are consistent with rules in place on other exchanges.<sup>40</sup>

Proposed Rule 1808(b), Trading Rotations, states that, except as otherwise provided in the proposed Rule, the opening process for index options shall be governed by Rule 503.<sup>41</sup> The opening rotation for index options shall be held at or as soon as practicable after 9:30 a.m. Eastern time. The Exchange may delay the commencement of the opening rotation in an index option whenever in the judgment of the Exchange such action is appropriate in the interests of a fair and orderly market. Among the factors that may be considered in making these determinations are: (1) unusual conditions or circumstances in other markets; (2) an influx of orders that has adversely affected the ability of the Market Maker to provide and to maintain fair and orderly markets; (3) activation of opening price limits in stock index futures on one or more futures exchanges; (4) activation of daily price limits in stock index futures on one or more futures exchanges; (5) the extent to which either there has been a delay in opening or trading is not occurring in stocks underlying the index; and (6) circumstances such as those which would result in the declaration of a fast market under Rule 506(d).<sup>42</sup>

Proposed Rule 1808(c) describes circumstances and procedures relating to halts and suspensions in index options. Specifically, trading on the Exchange in any index option shall be

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<sup>40</sup> See MIAX Options Rule 1808; Nasdaq ISE Rule 2008; Cboe Rule 24.6, and Nasdaq Phlx Rule 101.

<sup>41</sup> See Exchange Rule 503. Openings on the Exchange, governs the opening of trading on the Exchange with respect to, among other things, determining the opening price and matching orders and quotes in the system. These and other provisions will apply to openings in index options.

<sup>42</sup> This reference to MIAX Options Rule 506(d) will be construed to reference corresponding MIAX PEARL Rule 506(e).

halted or suspended whenever trading in underlying securities whose weighted value represents more than twenty percent (20%), in the case of a broad based index, and ten percent (10%) for all other indices, of the index value is halted or suspended. The Exchange also may halt trading in an index option, including in options on a Foreign Currency Index, when, in its judgment, such action is appropriate in the interests of a fair and orderly market and to protect investors. Among the facts that may be considered are the following:

(1) whether all trading has been halted or suspended in the market that is the primary market for a plurality of the underlying stocks, or in the case of a Foreign Currency Index, in the underlying foreign currency market;

(2) whether the current calculation of the index derived from the current market prices of the stocks is not available, or in the case of the a Foreign Currency Index, the current prices of the underlying foreign currency is not available;

(3) the extent to which the rotation has been completed or other factors regarding the status of the rotation; and

(4) other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present, including, but not limited to, the activation of price limits on futures exchanges.

Proposed Rule 1808(d) describes the resumption of trading following a halt or suspension in an index option. Trading in options of a class or series that has been the subject of a halt or suspension by the Exchange may resume if the Exchange determines that the interests of a fair and orderly market are served by a resumption of trading. Among the factors to be considered in making this determination are whether the conditions that led to the halt or suspension are no longer present, and the extent to which trading is occurring in stocks or currencies underlying an

index. Upon reopening, a rotation shall be held in each class of index options unless the Exchange concludes that a different method of reopening is appropriate under the circumstances, including but not limited to, no rotation, an abbreviated rotation or any other variation in the manner of the rotation.

Proposed Rule 1808(e) states that Rule 504, Interpretations and Policies .03 applies to index options trading with respect to the initiation of a market wide trading halt commonly known as a "circuit breaker."<sup>43</sup>

Proposed Rule 1808(f) addresses the hours for trading foreign currency options. Specifically, when the hours of trading of the underlying primary securities market for an index option do not overlap or coincide with those of the Exchange, all of the provisions as described in paragraphs (c), (d) and (e) above shall not apply except for (c)(4).

Proposed Rule 1808(g) governs the situation where the primary market for a security underlying the current index value of an index option does not open does not open for trading on a given day. In such a circumstance, the price of that security shall be determined, for the purposes of calculating the current index value at expiration, based on the opening price of that security on the next day that its primary market is open for trading. This procedure shall not be used if the current index value at expiration is fixed in accordance with the Rules and By-Laws of the Clearing Corporation.

The proposed rules governing trading sessions, including trading rotations, halts and suspensions, resumption of trading following a halt or suspension, circuit breakers, special

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<sup>43</sup> The Exchange shall halt trading in all securities whenever a market-wide trading halt commonly known as a circuit breaker is initiated on the New York Stock Exchange in response to extraordinary market conditions. See Exchange Rule 504, Interpretations and Policies .03. Rule 530(e) provides that the Exchange shall halt trading in all options whenever the equities markets initiate a market-wide trading halt commonly known as a circuit breaker in response to extraordinary market conditions.

provisions for foreign indices, and pricing when the primary market does not open are based on, and substantially similar to, the rules in place on other exchanges.<sup>44</sup>

Proposed Rule 1809, Terms of Index Options Contracts, outlines the terms of index options contracts in terms of the meaning of premium bids and offers; exercise prices; expiration months and the trading of European Style Index options. The proposed Rule also applies to A.M. Settled Index Options, and Long-Term Option Series (including Reduced-Value Long Term Options Series), which would also require a filing with the Commission for the specific index option(s) to which the proposed rule is applicable.<sup>45</sup>

Proposed Rule 1809(a) contains general provisions applicable to the trading of index options on the Exchange. Specifically, the proposed Rule states generally that bids and offers shall be expressed in terms of dollars and cents per unit of the index. The Exchange shall determine fixed-point intervals of exercise prices for call and put options. With respect to expirations, proposed Rule 1809(a)(3) states that index options contracts, including option contracts on a Foreign Currency Index, may expire at three (3)-month intervals or in consecutive months. The Exchange may list up to six (6) expiration months at any one time, but will not list index options that expire more than twelve (12) months out. Notwithstanding the preceding restriction, the Exchange may list up to seven expiration months at any one time for any broad-based security index option contracts on which any exchange calculates a constant three (3)-month volatility index.

Proposed Rule 1809(a)(4) permits the Exchange to list and trade certain European-style index options to be Specified by the Exchange, some of which may be A.M.-settled as provided

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<sup>44</sup> See, e.g., MIAX Options Rule 1808; Nasdaq ISE Rule 2008; Cboe Rule 24.7; and Nasdaq Phlx Rule 1047A.

<sup>45</sup> See supra note 5.

in paragraph (a)(5). The Exchange will file a proposed rule change and any such listing and trading is subject to the approval of the Commission.<sup>46</sup>

Proposed Rule 1809(a)(5) governs A.M.-Settled Index Options. The last day of trading for A.M.-settled index options shall be the business day preceding the business day of expiration, or, in the case of an option contract expiring on a day that is not a business day, the business day preceding the last day of trading in the underlying securities prior to the expiration date. The current index value at the expiration of an A.M.-settled index option shall be determined, for all purposes under these proposed Rules and the Rules of the Clearing Corporation, on the last day of trading in the underlying securities prior to expiration, by reference to the reported level of such index as derived from first reported sale (opening) prices of the underlying securities on such day, except that:

(i) In the event that the primary market for an underlying security does not open for trading on that day, the price of that security shall be determined, for the purposes of calculating the current index value at expiration, as set forth in Rule 1808(g), unless the current index value at expiration is fixed in accordance with the Rules and By-Laws of the Clearing Corporation; and

(ii) In the event that the primary market for an underlying security is open for trading on that day, but that particular security does not open for trading on that day, the price of that security, for the purposes of calculating the current index value at expiration, shall be the last reported sale price of the security.

Proposed Rule 1809(a)(5)(ii) permits the Exchange to list specific A.M.-settled index options that are approved for trading on the Exchange, subject to the filing of a proposed rule change and the approval of the Commission.

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<sup>46</sup> Id.

Proposed Rule 1809(b)(1) permits the Exchange, notwithstanding the permitted expiration months set forth in proposed Rule 1809(a)(3) (as described above), to list long-term index options series that expire from twelve (12) to sixty (60) months from the date of issuance. Under the proposal, long term index options series may be based on either the full or reduced value of the underlying index. There may be up to ten (10) expiration months, none further out than sixty (60) months. Strike price interval, bid/ask differential and continuity Rules shall not apply to such options series until the time to expiration is less than twelve (12) months. When a new long term index options series is listed, such series will be opened for trading either when there is buying or selling interest, or forty (40) minutes prior to the close, whichever occurs first. No quotations will be posted for such options until they are opened for trading.

Proposed Rule 1809(b)(2) governs the trading of reduced-value long term options series.<sup>47</sup> Proposed Rule 1809(b)(2)(i) permits the Exchange to list the specific reduced-Value long term options series traded on the Exchange (subject to an Exchange filing and Commission approval).<sup>48</sup> Reduced-value long term options series may expire at six-month intervals. When a new expiration month is listed, series may be near or bracketing the current index value. Additional series may be added when the value of the underlying index increases or decreases by ten (10) to fifteen percent (15%).

Proposed Rule 1809(c) sets forth the procedures for adding and deleting strike prices. The procedures for adding and deleting strike prices for index options are provided in Exchange Rule 404, as amended by the following:

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<sup>47</sup> A reduced-value options series is an option series overlying an index that trades in units based upon a percentage of the value of the underlying index, for example, ten percent (10%) of the value of the index.

<sup>48</sup> See supra note 5.

(1) The interval between strike prices will be no less than \$5.00; provided that in the case of certain classes of index options, the interval between strike prices will be no less than \$2.50 and such must be listed specifically in the Rule.

(2) New series of index options contracts may be added up to, but not on or after, the fourth business day prior to expiration for an option contract expiring on a business day, or, in the case of an option contract expiring on a day that is not a business day, the fifth business day prior to expiration.

(3) When new series of index options with a new expiration date are opened for trading, or when additional series of index options in an existing expiration date are opened for trading as the current value of the underlying index to which such series relate moves substantially from the exercise prices of series already opened, the exercise prices of such new or additional series shall be reasonably related to the current value of the underlying index at the time such series are first opened for trading. In the case of all classes of index options, the term "reasonably related to the current value of the underlying index" shall have the meaning set forth in proposed Rule 1809(c)(4), described below.

(4) Notwithstanding any other provision of this paragraph (c), the Exchange may open for trading additional series of the same class of index options as the current index value of the underlying index moves substantially from the exercise price of those index options that already have been opened for trading on the Exchange. The exercise price of each series of index options opened for trading on the Exchange shall be reasonably related to the current index value of the underlying index to which such series relates at or about the time such series of options is first opened for trading on the Exchange. The term "reasonably related to the current index value of



the underlying index" means that the exercise price is within thirty percent (30%) of the current index value.

The Exchange may also open for trading additional series of index options that are more than thirty percent (30%) away from the current index value, provided that demonstrated customer interest exists for such series, as expressed by institutional, corporate, or individual customers or their brokers. Market Makers trading for their own account shall not be considered when determining customer interest under this provision.

Proposed Rule 1809(d) states that the reported level of the underlying index that is calculated by the reporting authority on the business day of expiration, or, in the case of an option contract expiring on a day that is not a business day, the last day of trading in the underlying securities prior to the expiration date for purposes of determining the current index value at the expiration of an A.M.-settled index option, may differ from the level of the index that is separately calculated and reported by the reporting authority and that reflects trading activity subsequent to the opening of trading in any of the underlying securities.

Proposed Rule 1809(e) provides that the Rules of the Clearing Corporation specify that, unless the Rules of the Exchange provide otherwise, the current index value used to settle the exercise of an index options contract shall be the closing index value for the day on which the index options contract is exercised in accordance with the Rules of the Clearing Corporation or, if such day is not a business day, for the most recent business day. The closing settlement value for options on a Foreign Currency Index shall be specified by the Exchange.

Proposed Rule 1809, Interpretations and Policies .01, Short Term Option Series Program, specifies that, notwithstanding the restriction in Rule 1809(a)(3), after an option class has been approved for listing and trading on the Exchange, the Exchange may open for trading on any

Thursday or Friday that is a business day (“Short Term Option Opening Date”) series of options on that class that expire at the close of business on each of the next five Fridays that are business days and are not Fridays in which monthly options series or Quarterly Options Series expire (“Short Term Option Expiration Dates”). The Exchange may have no more than a total of five Short Term Option Expiration Dates. If the Exchange is not open for business on the respective Thursday or Friday, the Short Term Option Opening Date will be the first business day immediately prior to that respective Thursday or Friday. Similarly, if the Exchange is not open for business on a Friday, the Short Term Option Expiration Date will be the first business day immediately prior to that Friday.

Proposed Interpretations and Policies .01(a) to Rule 1809 permits the Exchange to select up to thirty (30) currently listed option classes on which Short Term Option Series may be opened on any Short Term Option Opening Date. In addition to the thirty (30) option class restriction, the Exchange may also list Short Term Option Series on any option classes that are selected by other securities exchanges that employ a similar program under their respective rules. For each index option class eligible for participation in the Short Term Option Series Program, the Exchange may open up to thirty (30) Short Term Option Series on index options for each expiration date in that class. The Exchange may also open Short Term Option Series that are opened by other securities exchanges in option classes selected by such exchanges under their respective short term option rules.

Proposed Interpretations and Policies .01(b) to proposed Rule 1809 states that no Short Term Option Series on an index option class may expire in the same week during which any monthly option series on the same index class expires or, in the case of Quarterly Options Series,

on an expiration that coincides with an expiration of Quarterly Options Series on the same index class.

Proposed Interpretations and Policies .01(c) to Rule 1809 governs the listing and trading of initial series in short-term options. The Exchange may open up to twenty (20) initial series for each option class that participates in the Short Term Option Series Program. The strike price of each Short Term Option Series will be fixed at a price per share, with approximately the same number of strike prices above and below the calculated index value of the underlying index at about the time that Short Term Option Series are initially opened for trading on the Exchange (e.g., if seven series are initially opened, there will be at least three strike prices above and three strike prices below the calculated index value). Any strike prices listed by the Exchange shall be within thirty percent (30%) above or below the current value of the underlying index.

Proposed Interpretations and Policies .01(d) to Rule 1809, Additional Series, states that the Exchange may open up to ten (10) additional series for each option class that participates in the Short Term Option Series Program when the Exchange deems it necessary to maintain an orderly market, to meet customer demand or when the current value of the underlying index moves substantially from the exercise price or prices of the series already opened. Any additional strike prices listed by the Exchange shall be within thirty percent (30%) above or below the current value of the underlying index. The Exchange may also open additional strike prices on Short Term Option Series that are more than thirty percent (30%) above or below the current value of the underlying index provided that demonstrated customer interest exists for such series, as expressed by institutional, corporate or individual customers or their brokers. Market Makers trading for their own account shall not be considered when determining customer interest under this provision. In the event that the underlying security has moved such that there are no series

that are at least ten percent (10%) above or below the current price of the underlying security, the Exchange will delist any series with no open interest in both the call and the put series having a: (i) strike higher than the highest strike price with open interest in the put and/or call series for a given expiration month; and (ii) strike lower than the lowest strike price with open interest in the put and/or the call series for a given expiration month, so as to list series that are at least ten percent (10%) but not more than thirty percent (30%) above or below the current price of the underlying security. In the event that the underlying security has moved such that there are no series that are at least ten percent (10%) above or below the current price of the underlying security and all existing series have open interest, the Exchange may list additional series, in excess of the thirty (30) allowed under this Interpretations and Policies .01. The opening of the new Short Term Option Series shall not affect the series of options of the same class previously opened. Notwithstanding any other provisions in proposed Rule 1809, Short Term Option Series may be added up to, and including on, the Short Term Option Expiration Date for that options series.

Proposed Interpretations and Policies .01(e) to Rule 1809 governs strike price intervals for short term index option series. The interval between strike prices on Short Term Option Series shall be the same as the strike prices for series in that same index option class that expire in accordance with the normal monthly expiration cycle. During the month prior to expiration of an index option class that is selected for the Short Term Option Series Program pursuant to this rule (“Short Term Option”), the strike price intervals for the related index non-Short Term Option (“Related non-Short Term Option”) shall be the same as the strike price intervals for the index Short Term Option.

Proposed Interpretations and Policies .02 to Rule 1809 governs the Quarterly Options Series Program. Notwithstanding the restriction in proposed Rule 1809(a)(3) (described above), the Exchange may list and trade options series that expire at the close of business on the last business day of a calendar quarter (“Quarterly Options Series”). The Exchange may list Quarterly Options Series for up to five (5) currently listed options classes that are either index options or options on exchange traded funds (“ETFs”). In addition, the Exchange may also list Quarterly Options Series on any options classes that are selected by other securities exchanges that employ a similar pilot program under their respective rules. The Exchange may list series that expire at the end of the next consecutive four (4) calendar quarters, as well as the fourth quarter of the next calendar year. The Exchange will not list a Short Term Option Series on an options class whose expiration coincides with that of a Quarterly Options Series on that same options class. Quarterly Options Series shall be P.M. settled.

Proposed Interpretations and Policies .02(d) to Rule 1809, Initial Series, states that the strike price of each Quarterly Options Series will be fixed at a price per share, with at least two, but no more than five, strike prices above and at least two, but no more than five, strike prices below the value of the underlying index at about the time that a Quarterly Options Series is opened for trading on the Exchange. The Exchange shall list strike prices for Quarterly Options Series that are reasonably related to the current index value of the underlying index to which such series relates at about the time such series of options is first opened for trading on the Exchange. The term “reasonably related to the current index value of the underlying index” means that the exercise price is within thirty percent (30%) of the current index value.

Proposed Interpretations and Policies .02(e) to Rule 1809, Additional Series, permits the Exchange to open for trading additional Quarterly Options Series of the same class when the

Exchange deems it necessary to maintain an orderly market, to meet customer demand or when the market price of the underlying security moves substantially from the initial exercise price or prices. The Exchange may also open for trading additional Quarterly Options Series that are more than thirty percent (30%) away from the current index value, provided that demonstrated customer interest exists for such series, as expressed by institutional, corporate, or individual customers or their brokers. Market-makers trading for their own account shall not be considered when determining customer interest under this provision. The Exchange may open additional strike prices of a Quarterly Options Series that are above the value of the underlying index provided that the total number of strike prices above the value of the underlying is no greater than five. The Exchange may open additional strike prices of a Quarterly Options Series that are below the value of the underlying index provided that the total number of strike prices below the value of the underlying index is no greater than five. The opening of any new Quarterly Options Series shall not affect the series of options of the same class previously opened.

Proposed Interpretations and Policies .02(f) to Rule 1809, Strike Interval, states that the interval between strike prices on Quarterly Options Series shall be the same as the interval for strike prices for series in that same options class that expire in accordance with the normal monthly expiration cycle.

Proposed Interpretations and Policies .03 to Rule 1809 states that, notwithstanding the requirements set forth in proposed Rule 1809, the Exchange may list additional series of index options classes if such series are listed on at least one other national securities exchange in accordance with the applicable rules of such exchange for the listing of index options.<sup>49</sup>

Proposed Interpretations and Policies .04 to Rule 1809 states that, notwithstanding the

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<sup>49</sup> See supra note 3.

requirements set forth in proposed Rule 1809 and any Interpretations and Policies thereto, the Exchange may list additional expiration months on options classes opened for trading on the Exchange if such expiration months are opened for trading on at least one other registered national securities exchange.

Proposed Interpretations and Policies .05 to Rule 1809 states that, notwithstanding the requirements set forth in this Rule 1809 and any Interpretations and Policies thereto, the Exchange may open for trading Short Term Option Series on the Short Term Option Opening Date that expire on the Short Term Option Expiration Date at strike price intervals of (i) \$0.50 or greater where the strike price is less than \$75, and \$1 or greater where the strike price is between \$75 and \$150 for all index option classes that participate in the Short Term Options Series Program; or (ii) \$0.50 for index option classes that trade in one dollar increments and are in the Short Term Option Series Program.

The proposed rules concerning the terms of options contracts are based on, and substantially similar to, rules that are currently operative on other exchanges.<sup>50</sup>

Proposed Rule 1810 applies to debit put spreads. Debit put spread positions in European-style, broad-based index options traded on the Exchange (hereinafter "debit put spreads") may be maintained in a cash account as defined by Federal Reserve Board Regulation T Section 220.8<sup>51</sup> by a Public Customer, provided that the following procedures and criteria are met:

(a) approval to maintain debit put spreads in a cash account carried by an Exchange Member. A customer so approved is hereinafter referred to as a "spread exemption customer."

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<sup>50</sup> See, e.g., MIAX Options Rule 1809; Nasdaq ISE Rule 2009; Cboe Rule 24.9; and Nasdaq Phlx Rule 1101A.

<sup>51</sup> 12 CFR 220.8.

(b) The spread exemption customer has provided all information required on Exchange-approved forms and has kept such information current.

(c) The customer holds a net long position in each of the stocks of a portfolio that has been previously established or in securities readily convertible, and additionally in the case of convertible bonds economically convertible, into common stocks which would comprise a portfolio. The debit put spread position must be carried in an account with a member of a self-regulatory organization participating in the ISG.

(d) The stock portfolio or its equivalent is composed of net long positions in common stocks in at least four industry groups and contains at least twenty (20) stocks, none of which accounts for more than fifteen percent (15%) of the value of the portfolio (hereinafter "qualified portfolio"). To remain qualified, a portfolio must at all times meet these standards notwithstanding trading activity in the stocks.

(e) The exemption applies to European-style broad-based index options dealt in on the Exchange to the extent the underlying value of such options position does not exceed the unhedged value of the qualified portfolio. The unhedged value would be determined as follows: (1) the values of the net long or short positions of all qualifying products in the portfolio are totaled; (2) for positions in excess of the standard limit, the underlying market value (A) of any economically equivalent opposite side of the market calls and puts in broad-based index options, and (B) of any opposite side of the market positions in stock index futures, options on stock index futures, and any economically equivalent opposite side of the market positions, assuming no other hedges for these contracts exist, is subtracted from the qualified portfolio; and (3) the market value of the resulting unhedged portfolio is equated to the appropriate number of exempt



contracts as follows – the unhedged qualified portfolio is divided by the correspondent closing index value and the quotient is then divided by the index multiplier or 100.

(f) A debit put spread in Exchange-traded broad-based index options with European-style exercises is defined as a long put position coupled with a short put position overlying the same broad-based index and having an equivalent underlying aggregate index value, where the short put(s) expires with the long put(s), and the strike price of the long put(s) exceeds the strike price of the short put(s). A debit put spread will be permitted in the cash account as long as it is continuously associated with a qualified portfolio of securities with a current market value at least equal to the underlying aggregate index value of the long side of the debit put spread.

(g) The qualified portfolio must be maintained with either a Member, another broker-dealer, a bank, or securities depository.

(h) The spread exemption customer shall agree promptly to provide the Exchange any information requested concerning the dollar value and composition of the customer's stock portfolio, and the current debit put spread positions.

(1) The spread exemption customer shall agree to and any Member carrying an account for the customer shall:

(i) comply with all Exchange Rules and regulations;

(ii) liquidate any debit put spreads prior to or contemporaneously with a decrease in the market value of the qualified portfolio, which debit put spreads would thereby be rendered excessive; and

(iii) promptly notify the Exchange of any change in the qualified portfolio or the debit put spread position which causes the debit put spreads maintained in the cash account to be rendered excessive.

(i) If any Member carrying a cash account for a spread exemption customer with a debit put spread position dealt in on the Exchange has a reason to believe that as a result of an opening options transaction the customer would violate this spread exemption, and such opening transaction occurs, then the Member has violated Rule 1810.

(j) Violation of any of these provisions, absent reasonable justification or excuse, shall result in withdrawal of the spread exemption and may form the basis for subsequent denial of an application for a spread exemption hereunder.

Proposed Rule 1811, Disclaimers, disclaims liability for index reporting authorities. The Disclaimer shall apply to the reporting authorities<sup>52</sup> identified in the Interpretations and Policies to proposed Rule 1801.<sup>53</sup>

Proposed Rule 1811(b), Disclaimer, provides that no reporting authority, and no affiliate of a reporting authority (each such reporting authority, its affiliates, and any other entity identified in this Rule are referred to collectively as a "Reporting Authority"), makes any warranty, express or implied, as to the results to be obtained by any person or entity from the use of an index it publishes, any opening, intra-day or closing value therefor, or any data included therein or relating thereto, in connection with the trading of any options contract based thereon or for any other purpose. The Reporting Authority shall obtain information for inclusion in, or for use in the calculation of, such index from sources it believes to be reliable, but the Reporting

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<sup>52</sup> The term "reporting authority" with respect to a particular index means the institution or reporting service designated by the Exchange as the official source for (1) calculating the level of the index from the reported prices of the underlying securities that are the basis of the index and (2) reporting such level. The reporting authority for each index approved for options trading on the Exchange shall be Specified (as provided in Rule 1800) in the Interpretations and Policies to Rule 1801. See proposed Rule 1801(n). See also supra note 5.

<sup>53</sup> The reporting authorities designated by the Exchange in respect of each index underlying an index options contract traded on the Exchange are as provided in a chart in proposed Rule 1801, Interpretations and Policies .01.

Authority does not guarantee the accuracy or completeness of such index, any opening, intra-day or closing value therefor, or any date included therein or related thereto. The Reporting Authority hereby disclaims all warranties of merchantability or fitness for a particular purpose or use with respect to such index, any opening, intra-day, or closing value therefor, any data included therein or relating thereto, or any options contract based thereon. The Reporting Authority shall have no liability for any damages, claims, losses (including any indirect or consequential losses), expenses, or delays, whether direct or indirect, foreseen or unforeseen, suffered by any person arising out of any circumstance or occurrence relating to the person's use of such index, any opening, intra-day or closing value therefor, any data included therein or relating thereto, or any options contract based thereon, or arising out of any errors or delays in calculating or disseminating such index.

Proposed Rule 1811 concerning Disclaimers is based on, and substantially similar to, rules that are currently operative on other exchanges.<sup>54</sup>

Proposed Rule 1812, Exercise of American-Style Index Options, contains standards for exercising American-style index options. The proposed rule provides that no Member may prepare, time stamp or submit an exercise instruction for an American-style index options series if the Member knows or has reason to know that the exercise instruction calls for the exercise of more contracts than the "net long position" of the account for which the exercise instruction is to be tendered. For purposes of this rule: (i) the term "net long position" shall mean the net position of the account in such option at the opening of business of the day of such exercise instruction, plus the total number of such options purchased that day in opening purchase transactions up to the time of exercise, less the total number of such options sold that day in closing sale

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<sup>54</sup> See, e.g., MIAX Options Rule 1811; Nasdaq ISE Rule 2011 and Cboe Rule 24.14.

transactions up to the time of exercise; (ii) the "account" shall be the individual account of the particular customer, market-maker or "non-customer" (as that term is defined in the By-Laws of the Clearing Corporation) who wishes to exercise; and (iii) every transaction in an options series effected by a market-maker in a market-maker's account shall be deemed to be a closing transaction in respect of the market-maker's then positions in such options series. No Member may adjust the designation of an "opening transaction" in any such option to a "closing transaction" except to remedy mistakes or errors made in good faith.

#### Trading Halts

The Exchange proposes to amend Rule 504, Trading Halts, Interpretations and Policies .04 to address the handling of trade nullifications in index options due to trading halts. Specifically, Interpretations and Policies .04 would be amended to state that, with respect to index options, trades on the Exchange will be nullified if the trade occurred during a regulatory halt as declared by the primary market in underlying securities representing more than ten percent (10%) of the current index value for narrow-based stock index options, and twenty percent (20%) of the current index value for broad-based index options. New Interpretations and Policies .05 to Rule 504 states that trading halts, resumptions, trading pauses and post-halt notifications involving index options are governed by Rules 1808(c)-(f) (described above).

#### Surveillance and Capacity

The Exchange represents that it has an adequate surveillance program in place for index options. The Exchange is a member of the ISG, which "is comprised of an international group of exchanges, market centers, and market regulators." The purpose of the ISG is to provide a framework for the sharing of information and the coordination of regulatory efforts among exchanges trading securities and related products to address potential intermarket manipulations

and trading abuses. The ISG plays a crucial role in information sharing among markets that trade securities, options on securities, security futures products, and futures and options on broad-based security indexes. A list identifying the current ISG members is available at <https://www.isgportal.org/isgportal/public/members.htm>.

MIAX PEARL has analyzed its capacity and represents that it believes the Exchange and the Options Price Reporting Authority (“OPRA”) have the necessary systems capacity to handle the additional traffic associated with the listing and trading of index options.

The Exchange will announce the implementation date of the proposed rule change by Regulatory Circular to be published no later than 90 days following the date the Commission issues an order approving the proposed rule change. The implementation date will be no later than 90 days following the issuance of the Regulatory Circular.

## 2. Statutory Basis

MIAX PEARL believes that its proposed rule change is consistent with Section 6(b) of the Act<sup>55</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>56</sup> in particular, in that it is 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 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 rule change will expand the Exchange’s capability to introduce and trade both existing and new and innovative index products on the MIAX PEARL System. The added capability is consistent with the Act in that it should foster

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<sup>55</sup> 15 U.S.C. 78f(b).

<sup>56</sup> 15 U.S.C. 78f(b)(5).

cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, specifically index options. The Exchange believes that there is unmet market demand on MIAX PEARL for exchange-listed index options and the listing and trading of index options on the Exchange is designed to attract both liquidity and order flow to the Exchange, all to the benefit of the marketplace as a whole.

The Exchange believes that the requirements in the proposed listing standards regarding, among other things, the minimum market capitalization, trading volume, and relative weightings of an underlying index's component stocks are designed to ensure that the markets for the index's component stocks are adequately capitalized and sufficiently liquid, and that no one stock dominates the index. These requirements are designed to 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, by ensuring that unusual or extreme volatility in any single component of an index could not cause the entire index to become so volatile that it puts investors at undue and unplanned risk. These requirements also minimize the potential for manipulating the underlying index, which protects investors and the public interest.

The Exchange further believes that the requirement in proposed Rule 1802(b)(10) that the current underlying index value will be reported at least once every fifteen (15) seconds during the time the index options are traded on the Exchange, and the requirement in proposed Rule 1802(d)(11) (with respect to broad-based index options) that the current index value be widely disseminated at least once every fifteen (15) seconds by OPRA, the CTA, NIDS or one or more major market data vendors during the time the index options are traded on the Exchange removes impediments to and perfects the mechanisms of a free and open market and a national market system by providing transparency with respect to current index values and by contributing to the

overall transparency of the market for index options. In addition, the Exchange believes that the requirement in proposed Rule 1802(d)(2) that an index option be A.M.-settled, rather than based on closing prices, should help to reduce the potential impact of expiring index options on the market for an index's component securities.

The Exchange believes that the requirement in proposed Rule 1803 to disseminate index values as a condition to the trading of options on an index fosters cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in, securities by requiring absolute transparency regarding the dissemination of index values. The requirement that the Exchange disseminate, or assure that the current index value is disseminated, and the requirement that the Exchange maintain, in files available to the public, information identifying the components whose prices are the basis for calculation of the index and the method used to determine the current index value, protects investors and the public interest by ensuring that the current index value is disseminated regularly and consistently.

The Exchange's proposal to adopt Rules 1804 through 1807 relating to position limits, exemptions from position limits, exercise limits in index options, and regular maintenance reviews are designed to 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, by limiting investors' levels of concentration in a single index position. Not only would an investor be at undue risk by assuming such a position, but the market for the affected index option could be disproportionately affected by the trading activities of that single investor with an unusually large long or short position. The Exchange is proposing to mitigate this risk by establishing the same position and exercise limits, and hedging rules, that already exist on other

exchanges, all designed for the protection of investors and the public interest.

Proposed Rule 1808, Trading Sessions, is designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in, securities, by establishing the same, uniform trading hours for index options as other exchanges. The Exchange's proposal to establish rules and procedures for openings, halts and reopenings, together with the designation by the Board of an Exchange official authorized to halt trading when, in his or her judgment, such action is appropriate in the interests of a fair and orderly market is designed to protect investors and the public interest by ensuring that there are multiple safeguards available during times of unusual or particularly volatile market activity.

Proposed Rule 1809, Terms of Index Options Contracts, outlines the terms of index options contracts in terms of the meaning of premium bids and offers; exercise prices; expiration months; the trading of European Style Index options. This proposed rule is the same as the rules concerning terms of index options contracts on other exchanges.<sup>57</sup> Proposed Rule 1809 is a generic rule concerning the manner of trading of index option contracts. The Exchange's proposal to adopt existing uniform rules governing terms of index option contracts is designed to perfect the mechanisms of a free and open market and a national market system and, in general, to protect investors and the public interest by adopting standards and rules for index option contracts that are consistent with other exchanges' standards and rules. The Exchange believes that this benefits investors and the marketplace as a whole because investors who determine to trade index options on MIAX PEARL will not need to rely on an unfamiliar set of rules and contract terms when they begin trading index options here.

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<sup>57</sup> See MIAX Options Rule 1809; Nasdaq ISE Rule 2009; Cboe Rule 24.9; and Nasdaq Phlx Rule 1101A.



The Exchange believes that its proposal to include index options in the Short Term Options Series Program removes impediments to, and perfects the mechanisms of, a free and open market and a national market system, and will benefit market participants by giving them more flexibility to closely tailor their investment and hedging decisions in a greater number of securities. The Exchange also believes that expanding the Short Term Options Series Program to include index options will provide the investing public and other market participants with additional opportunities to hedge their investment, thus allowing these investors to better manage their acceptable risk tolerance levels, all to the benefit of the investing public and the marketplace as a whole.

The Exchange's proposal to adopt Rule 1810 relating to debit put spreads fosters cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitates transactions in, securities, by maintaining uniformity in its rules governing this strategy with the same specificity as the rules on other exchanges.

Proposed Rule 1811 concerning Disclaimers is based on, and substantially similar to, rules that are currently operative on other exchanges.<sup>58</sup> The proposed rule promotes just and equitable principles of trade by stating that a Reporting Authority shall have no liability for any damages, claims, losses (including any indirect or consequential losses), expenses, or delays, whether direct or indirect, foreseen or unforeseen, suffered by any person arising out of any circumstance or occurrence relating to the person's use of an index, any opening, intra-day or closing value therefor, any data included therein or relating thereto, or any options contract based thereon, or arising out of any errors or delays in calculating or disseminating such index.

Proposed Rule 1812, Exercise of American-Style Index Options, is designed to prevent

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<sup>58</sup> See, e.g., MIAX Options Rule 1811; Nasdaq ISE Rule 2011 and Cboe Rule 24.14.

fraudulent and manipulative acts and practices and to promote just and equitable principles of trade by providing that no Member may prepare, time stamp or submit an exercise instruction for an American-style index options series if the Member knows or has reason to know that the exercise instruction calls for the exercise of more contracts than the then "net long position" of the account for which the exercise instruction is to be tendered. The proposed rule contains standards for exercising American-style index options that are in effect on other exchanges.<sup>59</sup>

The Exchange believes that its proposed surveillance program and available capacity with respect to the listing and trading of index options perfects the mechanisms of a free and open market and a national market system through, among other things, its membership in ISG and its current available capacity. As discussed above, the Exchange represents that it has an adequate surveillance program in place for index options. The Exchange is a member of the ISG, which "is comprised of an international group of exchanges, market centers, and market regulators." The purpose of the ISG is to provide a framework for the sharing of information and the coordination of regulatory efforts among exchanges trading securities and related products to address potential intermarket manipulations and trading abuses. The ISG plays a crucial role in information sharing among markets that trade securities, options on securities, security futures products, and futures and options on broad-based security indexes. A list identifying the current ISG members is available at <https://www.isgportal.org/isgportal/public/members.htm>. MIAX PEARL has analyzed its capacity and represents that it believes the Exchange and the Options Price Reporting Authority ("OPRA") have the necessary systems capacity to handle the additional traffic associated with the listing and trading of index options.

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<sup>59</sup> See, e.g., MIAX Options Rule 1812; Nasdaq ISE Rule 2012; Cboe Rule 24.18; and Nasdaq Phlx Rule 1042A.

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 that is not necessary or appropriate in furtherance of the purposes of the Act. On the contrary, the Exchange believes that the proposed rule change will enable the Exchange to compete for order flow in index options products with other exchanges that currently have rules and functionality in place to list and trade index options.

The Exchange further believes that the proposed rule change will enhance intra-market competition, as more varied index products become available for trading on the Exchange, which should encourage a greater number of Market Makers to trade index options, resulting in greater liquidity and more competitive quoting on the Exchange.

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

Written comments were neither solicited nor 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](mailto:rule-comments@sec.gov). Please include File Number SR-PEARL-2018-02 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-PEARL-2018-02. 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-PEARL-2018-02 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>60</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>60</sup> 17 CFR 200.30-3(a)(12).