

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-86946; File No. SR-GEMX-2019-10)

September 12, 2019

Self-Regulatory Organizations; Nasdaq GEMX, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend the Priority of Quotes and Orders Rule

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 28, 2019, Nasdaq GEMX, LLC (“GEMX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend GEMX Options 2, Section 5 titled “Market Maker Quotations,” Options 3, Section 7, titled “Types of Orders,” and Options 3, Section 10, titled “Priority of Quotes and Orders.”

The text of the proposed rule change is available on the Exchange’s Website at <http://nasdaqgemx.cchwallstreet.com/>, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in

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

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

Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The Exchange proposes to amend Options 3, Section 10, titled “Priority of Quotes and Orders” to provide additional detail to the rule and make other technical and organizational modifications. The Exchange also proposes to amend cross-references within Options 2, Section 5 titled “Market Maker Quotations” and Options 3, Section 7, titled “Types of Orders.” Finally, the Exchange proposes to relocate certain rule text as described herein. Each change is described below in detail. This rule change is intended to further clarify the Exchange’s current allocation process. This rule change does not amend the current System.

Options 3, Section 10

The Exchange proposes to retitle this rule, “Allocation and Priority of Quotes and Orders.”

*Definitions*

The Exchange proposes to capitalize the defined terms “Market Order”<sup>3</sup> and “Limit Order”<sup>4</sup> within Options 3, Section 10.

The Exchange proposes to amend Options 3, Section 10(a) to re-title this section “Definitions and Applicability” instead of simply “Definitions.” The Exchange proposes to renumber the current rule text as “(i)” and add the following to proposed new “(ii)”:

**Applicability.** This rule does not apply to the Block Order Mechanism described within Options 3, Section 11(a), the Facilitation Mechanism

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<sup>3</sup> Market Order is defined within Options 3, Section 7(a).

<sup>4</sup> Limit Order is defined within Options 3, Section 7(b).

described within Options 3, Section 11(b), the Solicited Order Mechanism described within Options 3, Section 11(d), the Price Improvement Mechanism described within Options 3, Section 13, orders described within Options 3, Section 12 or an exposure period as provided in Options 5, Section 2 at Supplementary Material .02, unless Options 3, Section 10 is specifically referenced within GEMX Rules applicable to the aforementioned functionality.

The Exchange notes that today, Options 3, Section 10 is applicable to interest on the Order Book. The Exchange has separate and distinct rules for functionality related to the Block Order Mechanism, the Facilitation Mechanism and the Solicited Order Mechanism within Options 3, Section 11, the Price Improvement Mechanism within Options 3, Section 13, and an exposure period as provided in Options 5, Section 2 at Supplementary Material .02. The Exchange proposes to make clear that Options 3, Section 10 shall not apply to the aforementioned functionalities unless Options 3, Section 10 is specifically referred to within GEMX Rules applicable to the aforementioned functionality. The Exchange notes that the current Options 3, Section 10 at Commentary .01(c) only makes reference to the Facilitation Mechanism. The Exchange notes that it is amending the rule to reflect all the mechanisms which have their own allocation methodologies. Proposed Options 3, Section 10(a)(ii) reflects the current System. This is not a change to the current System. The Exchange believes that adding the proposed applicability section will better explain the interaction as between Options 3, Section 10 and other trading functionality.

#### Zero-Bid

The Exchange proposes to create a new proposed Options 3, Section 10(b)(1) and title that rule “Zero-Bid Option Series.” The Exchange proposes to capitalize the defined terms “Market Order”<sup>5</sup> and “Limit Order” within this rule. The Exchange proposes to amend the first

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<sup>5</sup> Market Order is defined within Options 3, Section 7(a).

sentence to add the phrase “accepted by the System” to provide more context to the rule. This rule does not apply to a Market Order that is not accepted because it was rejected upon entry.<sup>6</sup>

The Exchange also proposes to add greater detail to the zero bid rule by providing, “With respect to Market Orders to sell which are submitted prior to the Opening Process and persist after the Opening Process, those orders are posted at a price equal to the minimum trading increment as defined in Options 3, Section 3.” This detail represents the Exchange’s current practice. The Exchange believes this rule text will add greater detail to the GEMX rule which operates in a similar manner to the Nasdaq Phlx, LLC (“Phlx”).<sup>7</sup>

### Priority

The Exchange proposes to amend Options 3, Section 10 because the proposed description of priority adds greater detail to each allocation tier. The general allocation and priority provisions are contained within the Supplementary Material to Options 3, Section 10. The rule therefore needs to be read by referring to the Supplementary Material while reading the main rule. The Exchange proposes to amend the current priority rule within Options 3, Section 10 to explain the allocation of interest and the priority of such allocation in a timeline format to avoid confusion and ease the reading of the rule. Further, the Exchange proposes to add greater detail to the current rule.

The Exchange proposes to rename current Options 3, Section 10(c) titled, “Priority,” as “Execution Priority and Processing in the System.” The Exchange proposes to provide greater detail to this rule. The Exchange proposes to state that it will apply a Size Pro-Rata execution algorithm to orders, unless otherwise specified. The Exchange proposes to detail the manner in

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<sup>6</sup> For example, a Market Order that is rejected due to Limit-Up Limit-Down would not be treated as a Limit Order because it was not accepted by the System.

<sup>7</sup> See Phlx 1035, which contains a similar sentence as proposed herein.

which it applies Size Pro-Rata execution today by stating, “The System shall execute trading interest within the System in price priority, meaning it will execute all trading interest at the best price level within the System before executing trading interest at the next best price. Size Pro-Rata Priority shall mean that if there are two or more resting orders or quotes at the same price, the System allocates contracts from an incoming order or quote to resting orders and quotes beginning with the resting order or quote displaying the largest size proportionally according to displayed size, based on the total number of contracts displayed at that price. If the result is not a whole number, it will be rounded up to the nearest whole number. If there are still contracts to be allocated after the displayed size of all orders at that price has been executed, the remaining size from the incoming order will be allocated proportionally against non-displayed interest according to remaining total size of each resting order at such price, beginning with the order which has the largest total size remaining.” The Exchange notes that this proposed rule text represents the Exchange’s current practice. The Exchange is not amending the manner in which it applies the Size Pro-Rata allocation. This practice is explained in Supplementary Material .01(a) to Options 3, Section 10 wherein it states, “Professional Orders and market maker quotes at the best price receive allocations based upon the percentage of the total number of contracts available at the best price that is represented by the size of the Professional Order or quote.” The Exchange believes that this rule text will provide Members with transparency as to the allocation methodology applied within the System.

The Exchange proposes to add a new Options 3, Section 10(c)(1) which provides, “Priority Overlays Applicable to Size Pro-Rata Execution Algorithm: the Exchange will apply the following designated Member priority overlays. No Member shall be entitled to receive a number of contracts that is greater than the size that is associated with their quotation or order.”

This language represents current practice within Supplementary Material .01(c) to Options 3, Section 10. The Exchange is proposing to introduce each priority category in the order that they are allocated, as is currently expressed in the rule today, and note specifically that no Member may receive an allocation greater than their size which is the case today. Current rule text within Supplementary Material .01(c) to Options 3, Section 10 provides, “No market participant is allocated any portion of an execution unless it has an existing interest at the execution price. Moreover, no market participant can execute a greater number of contracts than is associated with the price of its existing interest.”

The below priority overlays described herein will be applied by the Exchange as explained within the proposed rule for all options series.

### **Priority Customer**

Proposed Options 3, Section 10(c)(1)(A) describes Priority Customer<sup>8</sup> allocation. As is the case today, Priority Customers on the Exchange have priority over other market participants at the same price and in the same option series as specified in current Options 3, Section 10(c). The Exchange proposes to replace Options 3, Section 10(c) and (d) with the following rule text which represents the current System:

(A) **Priority Customer:** the highest bid and lowest offer shall have priority except that Priority Customer orders shall have priority over non-Priority Customer interest at the same price in the same options series. If there are two or more Priority Customer orders for the same options series at the same price, priority shall be afforded to such Priority Customer orders in the sequence in which they are received by the System.

The Exchange proposes to initially note the priority that is afforded to Priority Customers and

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<sup>8</sup> The term “Priority Customer” means a person or entity that (i) is not a broker or dealer in securities, and (ii) does not place more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). See Options 1, Section 1 (a)(36).

make clear that time priority continues to apply. Specifically, the Exchange proposes to make clear in the introductory paragraph of proposed Options 3, Section 10(c) that non-displayed Priority Customer interest will not trade ahead of other displayed interest at the same price regardless of the displayed interest's capacity, as is the case today within Options 3, Section 10(1)(c) and (d). The Exchange believes that the proposed rule text provides clarity to the current allocation methodology.

### **Primary Market Maker**

The Exchange proposes new rule text at Options 3, Section 10(c)(1)(B) to describe the current manner in which the System handles Enhanced Primary Market Maker<sup>9</sup> Priority:

**Enhanced Primary Market Maker Priority:** A Primary Market Maker may be assigned by the Exchange in each option class in accordance with Options 2, Section 3(b). After all Priority Customer orders have been fully executed, provided the Primary Market Maker's quote is at the NBBO, the Primary Market Maker shall be entitled to receive the allocation described in Options 3, Section 10(c)(1)(B)(i), unless the incoming order to be allocated is a Preferred Order and the Primary Market Maker is not the Preferred Market Maker, in which case allocation would be pursuant to (c)(1)(C). If the order is a Preferred Order and the Primary Market Maker is also the Preferred Market Maker ("Preferred Market Maker Priority") then the Preferred Market Maker Participation Entitlement in (c)(1)(C) or (c)(1)(E) applies. The Primary Market Maker shall not be entitled to receive a number of contracts that is greater than the size associated with such Primary Market Maker's quote.

The Exchange proposes to note that a Primary Market Maker may be assigned by the Exchange in each option class in accordance with Options 2, Section 3(b). Reiterating the priority afforded to Priority Customer orders, the Exchange notes that Priority Customers must be first fully executed and then Primary Market Maker allocation would be accounted for in that order.

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<sup>9</sup> The term "Primary Market Maker" means a Member that is approved to exercise trading privileges associated with PMM Rights. See Options 1, Section 1(a)(34).

The Exchange proposes to state that provided the Primary Market Maker's quote is at the NBBO the Primary Market Maker shall be entitled to receive the allocation described in Options 3, Section 10(c)(1)(B)(i), unless the incoming order to be allocated is a Preferred Order and the Primary Market Maker is not the Preferred Market Maker.

Current Options 3, Section 10(e) provides,

*Precedence of Professional Orders and Market Maker Quotes.* Except as provided under Options 3, Section 7(g), if there are two (2) or more Professional Orders or Market Maker quotes at the Exchange's best bid or offer, after all Priority Customer Orders (if any) at that price have been filled, executions at that price will be allocated between the Professional Orders and Market Maker quotes pursuant to an allocation procedure to be determined by the Exchange from time to time; provided, however, that if the Primary Market Maker is quoting at the Exchange's best bid or offer, it shall have precedence over Professional Orders and Competitive Market Maker quotes for execution of orders that are for a specified number of contracts or fewer, which number shall be determined by the Exchange from time to time.

Current Supplementary Material .01 to Options 3, Section 10(a) and (b) provide,

(a) Subject to the two limitations in paragraphs (b) and (c) below and subject to paragraph .03 (Preferred Orders), Professional Orders and Market Maker quotes at the best price receive allocations based upon the percentage of the total number of contracts available at the best price that is represented by the size of the Professional Order or quote;

(b) If the Primary Market Maker is quoting at the best price, it has participation rights equal to the greater of (i) the proportion of the total size at the best price represented by the size of its quote, or (ii) sixty percent (60%) of the contracts to be allocated if there is only one (1) other Professional Order or Market Maker quotation at the best price, forty percent (40%) if there are two (2) other Professional Orders and/or Market Maker quotes at the best price, and thirty percent (30%) if there are more than two (2) other Professional Orders and/or Market Maker quotes at the best price...

The current rule text describes the precedence of orders for Professional Orders<sup>10</sup> and

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<sup>10</sup> The term "Professional Order" means an order that is for the account of a person or entity that is not a Priority Customer. See Options 1, Section 1(a)(37).



market maker<sup>11</sup> quotes together. The Exchange notes that Primary Market Makers may receive certain allocations that other market participants do not receive and therefore the Exchange is proposing to provide for Primary Market Maker allocations separately and then account for allocations of all other market participant allocations. As is the case today, after Priority Customers are allocated, Primary Market Makers would be allocated before any other market participant. The Exchange notes that pursuant to the current rule, a Primary Market Maker quoting at the Exchange's best bid or offer shall have precedence over Professional Orders and Competitive Market Maker quotes for execution of orders that are for a specified number of contracts or fewer.

First, the Exchange proposes to replace the term "best price" with "NBBO."<sup>12</sup> The best price in this case is the NBBO. The amendment to this term does not reflect a substantive change to the current System. With respect to a Primary Market Maker's quote, the quote will not be executed at a price that trades through another market or displayed at a price that would lock or cross another market. The "NBBO" is the best Protected Bid and Protected Offer as defined in the Options Order Protection and Locked/Crossed Markets Plan; Protected Bids and Protected Offers that are displayed at a price but available on the Exchange at a better non-

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<sup>11</sup> The term "Market Makers" refers to "Competitive Market Makers" and "Primary Market Makers" collectively. See Options 1, Section 1(a)(20). The term "Competitive Market Maker" means a Member that is approved to exercise trading privileges associated with CMM Rights. See Options 1, Section 1(a)(11).

<sup>12</sup> A Primary Market Maker's quote may be executed at the BBO provided the BBO is not inferior to the NBBO. The Primary or Preferred Market Maker may receive either the Enhanced Primary Market Maker Allocation or the Preferred Market Maker Allocation if they are quoting at the BBO, which would be equivalent to the NBBO, if an ISO Order is received because the ISO Order would have been routed simultaneously with other orders to any better priced interest at away markets in accordance with GEMX Options 5, Section 1(h). Other options markets have a rule equivalent to Options 5, Section 1(h). See also Options 3, Section 7(b)(4) which provides, "An Intermarket Sweep Order (ISO) is a limit order that meets the requirements of Options 5, Section 1(h)."

displayed price shall be included in the NBBO at their better non-displayed price for purposes of this rule.<sup>13</sup>

Second, the Exchange proposes to replace the words “other Professional Orders and market maker quotes” with “other non-Priority Customer orders and Market Maker quotes.” While the term “Professional Orders” is defined within Options 1, Section 1(a)(37) to mean an order that is for the account of a person or entity that is not a Priority Customer, the Exchange believes that simply stating “non-Priority Customer” is a less circular manner in which to describe the type of market participant to which the allocation applies. The Exchange believes that the term “non-Priority Customer” reduces any confusion regarding any reference to Professional Order or Professional Customer. Orders and quotes are counted individually for purposes of allocation even if they are from the same market participant.<sup>14</sup> The Exchange notes that if a Competitive Market Maker had both a quote and order at the NBBO, the Competitive Market Maker’s quote and order would be considered separately for purposes of allocation pursuant to proposed Options 3, Section 10(c)(1)(E) based on Size Pro-Rata. Whichever quote or order is larger at the best price level will be allocated first based on its individually represented size. This amendment is not a change to current System operations.

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<sup>13</sup> See 17 CFR 242.600(a)(43). National best bid and national best offer means, with respect to quotations for an NMS security, the best bid and best offer for such security that are calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan; provided, that in the event two or more market centers transmit to the plan processor pursuant to such plan identical bids or offers for an NMS security, the best bid or best offer (as the case may be) shall be determined by ranking all such identical bids or offers (as the case may be) first by size (giving the highest ranking to the bid or offer associated with the largest size), and then by time (giving the highest ranking to the bid or offer received first in time).

<sup>14</sup> For example, if a Competitive Market Maker submits 2 orders and one quote, this would equate to 3 non-Priority Customer interest (orders and quotes) for purposes of determining the number of market participants for the allocation percentage.

Third, the Exchange proposes to reiterate the language in current Supplementary Material .01(b) to Options 3, Section 10 by stating within proposed Options 3, Section 10(c)(1)(B)(i),

(i) When the Primary Market Maker is at the same price as a non-Priority Customer Order or Market Maker quote and the number of contracts is greater than 5, the Primary Market Maker shall receive the greater of:

a. 60% of remaining interest if there is one other non-Priority Customer Order or Market Maker quote at that price; 40% of remaining interest if there are two other non-Priority Customer Orders or Market Maker quotes at that price; or 30% of remaining interest if there are more than two other non-Priority Customer Orders and Market Maker quotes at that price ( the “Primary Market Maker Participation Entitlement”); or

b. the Primary Market Maker’s Size Pro-Rata share under subparagraph (a)(1)(E) (“All Other Remaining Interest”).

Fourth, the Exchange proposes to provide within Options 3, Section 10(a)(1)(B) the following new rule text, “The Primary Market Maker shall not be entitled to receive a number of contracts that is greater than the size associated with such Primary Market Maker’s quote.” This is also the case today.

The Exchange proposes to explain the allocation methodology based on the size of the order within Options 3, Section 10(c)(1)(B)(i). When the number of contracts is greater than 5 allocation would be pursuant to Options 3, Section 10(c)(1)(B) and when the number of contracts is 5 or fewer, allocation would be pursuant to Options 3, Section 10(c)(1)(D). Further, the Exchange proposes within proposed Options 3, Section 10(c)(1)(B) to distinguish when the Primary Market Maker and the Preferred Market Maker Participation Entitlement apply. The Exchange notes if the incoming order to be allocated is a Preferred Order and the Primary Market Maker is not the Preferred Market Maker, allocation would be pursuant to (c)(1)(C) provided the Preferred Market Maker’s quote is at the NBBO. The Preferred Market Maker allocation is provided for within proposed Options 3, Section 10(c)(1)(C). If the order is a

Preferred Order and the Primary Market Maker is also the Preferred Market Maker (“Preferred Market Maker Priority”) then the Preferred Market Maker Participation Entitlement in (c)(1)(C) or (c)(1)(E) applies, depending on whether the Primary Market Maker is quoting at the NBBO.

### **Preferred Market Maker**

The Exchange proposes to provide for the allocation that a Preferred Market Maker is entitled to within proposed Options 3, Section 10(c)(1)(C). The Exchange notes within proposed Options 3, Section 10(c)(1)(B) that if the incoming order to be allocated is a Preferred Order and the Primary Market Maker is not the Preferred Market Maker, the Enhanced Primary Market Maker Priority shall not apply. The Exchange rules currently provides within Supplementary Material .03 to Options 3, Section 10 the following:

**Preferred Orders.** An Electronic Access Member may designate a “Preferred Market Maker” on orders it enters into the System (“Preferred Orders”).

(a) A Preferred Market Maker may be the Primary Market Maker appointed to the options class or any Competitive Market Maker appointed to the options class.

(b) If the Preferred Market Maker is not quoting at a price equal to the NBBO at the time the Preferred Order is received, the allocation procedure contained in paragraph .01 shall be applied to the execution of the Preferred Order.

(c) If the Preferred Market Maker is quoting at the NBBO at the time the Preferred Order is received, the allocation procedure contained in paragraph .01 shall be applied to the execution of the Preferred Order except that the Primary Market Maker will not receive the participation rights described in paragraphs .01(b) and (c), and instead the Preferred Market Maker shall have participation rights equal to the greater of:

(i) the proportion of the total size at the best price represented by the size of its quote,

(ii) sixty percent (60%) of the contracts to be allocated if there is only one (1) other Professional Order or market maker quotation at the best price and forty percent (40%) if there are two (2) or more other Professional Orders and/or market maker quotes at the best price, or

(iii) the full size of a Preferred Order for five (5) contracts or fewer if the Primary Market Maker appointed to the options class is designated as the Preferred Market Maker.

First, the Exchange proposes to amend cross-references within this current rule text and relocate certain rule text into new proposed Options 3, Section 10(c)(1)(C) which proposes to state,

**(C) Preferred Market Maker Priority:** After all Priority Customer orders have been fully executed, upon receipt of a Preferred Order pursuant to Supplementary .01 to Options 3, Section 10, provided the Preferred Market Maker's quote is at the NBBO, the Preferred Market Maker will be afforded a participation entitlement. Preferred Market Maker participation entitlements will apply only after the Opening Process.

(i) When the Preferred Market Maker is at the same price as a non-Priority Customer Order or Market Maker quote, pursuant to the Preferred Market Maker participation entitlement, the Preferred Market Maker shall receive, with respect to a Preferred Order, the greater of:

- a. 60% of remaining interest if there is one other non-Priority Customer Order or Market Maker quote at that price; or 40% of remaining interest if there are two or more other non-Priority Customer Orders or Market Maker quotes at that price; or
- b. the Preferred Market Maker's Size Pro-Rata share under subparagraph (c)(1)(E) ("All Other Remaining Interest"); or
- c. the entitlement for Orders of 5 Contracts or Fewer under subparagraph (c)(1)(D) if the Preferred Market Maker is also the Primary Market Maker and the incoming Order is for 5 Contracts or Fewer.

Second, the Exchange is proposing to reiterate that a Preferred Market Maker shall be allocated after Priority Customer orders have been fully executed. The Exchange notes that the Preferred Market Maker's bid/offer must be at the NBBO for an entitlement to apply. The Exchange notes that the Preferred Market Maker participation entitlements will apply only after the Opening Process. This is the case today, but is not currently noted within Options 3, Section 10. The Exchange proposes to memorialize this limitation for clarity.

Third, the Exchange proposes to replace the words “other Professional Orders and market maker quotes” with “other non-Priority Customer Orders and Market Maker quotes.” The Exchange believes that the term “non-Priority Customer” reduces any confusion regarding any reference to Professional Order or Professional Customer. Orders and quotes are counted individually for purposes of allocation even if they are from the same market participant. This amendment is not a change to current System operations.

The new proposed rule text seeks to capture allocation text currently within Supplementary Material .03 to Options 3, Section 10 and add text to demonstrate the interaction between the Entitlement for Orders of 5 Contracts or Fewer and the new proposed bucket of allocation within proposed Options 3, Section 10(c)(1)(E) for all other market participants. The Exchange believes that new rule text makes clear the manner in which the various allocations interact with one another and make clear that the Member is entitled to the greater of all potential allocations.

#### **Orders for 5 Contracts or fewer**

Current Supplementary .01(c) to Options 3, Section 10 provides,

Orders for five (5) contracts or fewer will be executed first by the Primary Market Maker; provided however, that on a quarterly basis the Exchange will evaluate what percentage of the volume executed on the Exchange (excluding volume resulting from the execution of orders in the Facilitation Mechanism (see Options 3, Section 11(d))) is comprised of orders for five (5) contracts or fewer executed by Primary Market Makers, and will reduce the size of the orders included in this provision if such percentage is over forty percent (40%).

The Exchange proposes new rule text within Options 3, Section 10(c)(1)(D) to specifically describe in greater detail the manner in which Orders of 5 Contracts or Fewer are handled. The Exchange notes that the Entitlement for Orders of 5 Contracts or Fewer shall only apply after the Opening Process. The Exchange noted within proposed Options 3, Section 10(a)(ii) that Options 3, Section 10 was not applicable to the Block Order Mechanism,

Facilitation Mechanism or the Solicited Order Mechanism within Options 3, Sections 11, the Price Improvement Mechanism within Options 3, Section 13 and an exposure period as provided in Options 5, Section 2 at Supplementary Material .02, unless Options 3, Section 10 is specifically referenced within GEMX Rules applicable to the aforementioned functionality. These limitations apply today and the Exchange proposes to memorialize the limitations within the rule for clarity. The Exchange proposes to amend and relocate the language concerning the quarterly evaluation into this proposed new rule text. Specifically, the Exchange proposes to delete the rule text which excludes volume resulting from the execution of orders in the Facilitation Mechanism as explained herein with the proposed applicability rule text. The Exchange specifically describes allocating orders on the Order Book within Options 3, Section 10. The Exchange describes functionality and allocations for the Block Order Mechanism, the Facilitation Mechanism, the Solicited Order Mechanism, the Price Improvement Mechanism, orders described within Options 3, Section 11 or an exposure period within other GEMX Rules.<sup>15</sup> The Entitlement for Orders of 5 Contracts or Fewer is only allocated pursuant to proposed Options 3, Section 10(c)(1)(D) and applies specifically to the Order Book.

The Exchange proposes to make clear the manner in which Orders of 5 Contracts or Fewer may be allocated by providing that a Primary Market Maker is entitled to priority with respect to Orders of 5 Contracts or Fewer if the Primary Market Maker has a quote at the NBBO with no other Priority Customer or Preferenced Market Maker interest present which has a higher priority, including when the Primary Market Maker is also the Preferred Market Maker. Further, the Exchange notes that if the Primary Market Maker is quoting at the NBBO and the Primary Market Maker is also the Preferred Market Maker or there is no Preferred Market Maker quoting

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<sup>15</sup> See Options 5, Section 2 at Supplementary Material .02, unless Options 3, Section 10.

at the NBBO, and a Priority Customer has a higher priority at the time of execution, the Priority Customer will be allocated the Orders of 5 Contracts or Fewer up to their displayed size<sup>16</sup> pursuant to Options 3, Section 10(c)(1)(A) and if contracts remain, the Primary Market Maker will be allocated the remainder pursuant to Options 3, Section 10(c)(1)(D).<sup>17</sup> Finally, if the Primary Market Maker is quoting at the NBBO and no Priority Customer has a higher priority at the time of execution and a Preferred Market Maker, who is not the Primary Market Maker, is quoting at the NBBO then allocation shall proceed according to Options 3, Section 10(c)(1)(C). This rule text represents the current practice. The Exchange believes that spelling out the potential scenarios and explaining the resulting allocations will make the allocation of Orders of 5 Contracts or Fewer more transparent.

The Exchange proposes a new category of allocation for all other market participants. The Exchange proposes to note within proposed new Options 3, Section 10(c)(1)(E), “If there are contracts remaining after all priorities in (A)-(D) have been fully executed, notwithstanding Options 3, Section 7(g)(3),<sup>18</sup> such contracts shall be executed based on the Size Pro-Rata execution algorithm as described within Options 3, Section 10(c). The Exchange notes that the priority of allocation for all other market participants’ changes with respect to the order in which

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<sup>16</sup> The Exchange notes that the inverse is also true. If the Primary Market Maker is quoting at the NBBO and the Preferred Market Maker is not the Primary Market Maker and is quoting at the NBBO then the Priority Customer would receive the allocation.

<sup>17</sup> The Primary Market Maker may receive the remaining contracts (i.e. if a Priority Customer has 1 contract order and the Primary Market Maker and a Competitive Market Maker have 5 contracts each, an incoming order of 5 contracts would be allocated such that the Priority Customer receives 1 contract and the remaining 4 contracts would be allocated to the Primary Market Maker).

<sup>18</sup> Options 3, Section 7(g) concerns Reserve Orders. A Reserve Order is a limit order that contains both a displayed portion and a non-displayed portion. Specifically, Options 3, Section 7(g) provides, “The displayed portion of a Reserve Order will trade in accordance with Options 3, Section 10(c) and (d) for Priority Customer Orders, and Options 3, Section 10(e) and Supplementary Material .01, for Professional Orders.”



displayed and non-displayed volume is allocated for non-Priority Customer market participants. Displayed volume will be allocated before non-displayed volume. Further Priority Customer non-displayed Reserve Orders will be allocated before non-Priority Customer non-displayed Reserve Orders. Proposed Options 3, Section 10(c) describes the manner in which Priority Customers are allocated pursuant to Size Pro-Rata priority. The Exchange believes that separating out all other market participants as a new category as well as referring to the allocation methodology within each bucket of allocation will make clear the manner in which the Exchange allocates. This amendment does not change the operation of the current System.

Finally, the Exchange proposes to state that, “A Market Maker is entitled only to an Enhanced Primary Market Maker Priority pursuant to Options 3, Section 10(c)(1)(B) or the Entitlement for Orders of 5 Contracts or Fewer pursuant to Options 3, Section 10(c)(1)(D) on a quote, or the Preferred Market Maker Priority pursuant to Options 3, Section 10(c)(1)(C) on a quote.” The Exchange believes that this text makes clear that only a market maker quote may receive these enhanced allocations. Only a Primary Market Maker quote entitles a Primary Market Maker to the allocations within Options 3, Section 10(c)(1)(B) or (D) while a quote or a Market Maker Order entitles a Preferred Market Maker to the allocation within Options 3, Section 10(c)(1)(C). This amendment does not change the operation of the current System.

#### **Current Rule Text**

The Exchange proposes to delete current Options 3, Section 10(c)-(e) as this rule text is being replaced by proposed Options 3, Section 10(c)(1)(A), (B) and (E). The Exchange proposes to delete current Supplementary Material .01 to Options 3, Section 10 which is being replaced by proposed Options 3, Section 10(a)(1)(A), (B), (D) and (E). The Exchange proposes to delete current Supplementary Material .02 to Options 3, Section 10 which is reserved.

The Exchange proposes to relocate current Supplementary Material .03 (a) and (b) and part of (c) to Options 2, Section 10, which is currently reserved, and title that section “Preferred Orders”. The Exchange is proposing to delete part of current Supplementary Material .03(c) to Options 3, Section 10 which is being replaced by proposed Options 3, Section 10(c)(1)(C). The Exchange believes that providing a separate rule for Preferred Orders will make it easier to locate.

GEMX Options 3, Section 7(g) and Options 2, Section 4

The Exchange proposes to amend Options 3, Section 7 and Options 2, Section 4 to update cross-references to Options 3, Section 10.

The Exchange also proposes, similar to the changes made within Options 3, Section 10 to remove the term “Professional” and substitute that term with a broader term. In this case, the Exchange proposes to utilize the term “non-Priority Customer” in place of Professional to indicate market participants who are not Priority Customers.

**Examples:**

1. Size-Pro Rate Description. *This provides a description of size pro-rata allocation.*

Primary Market Maker quote 10@8.00 x 10@12.00  
Order1 Priority Customer Buy 1@8.00  
Order2 Priority Customer Reserve Buy 25@8.00 (display qty = 5)  
Order3 Firm Reserve Buy 25@8.00 (display qty = 5)  
Order4 Firm Buy 25@8.00  
Order5 Firm Reserve Buy 10@8.00 (display qty = 5)  
Sell 75 @ 8.00

First Allocation Tier – Priority Customer, displayed, price time  
Sell order trades with:  
-Order1 1@8.00  
-Order2 5@8.00 (displayed only)

Second Allocation Tier – non- Priority Customer, displayed, pro-rata  
Sell Order Trades with:  
-Order4 25@8.00  
-Order3 5@8.00

- Order5 5@8.00

Order 4 has priority because it is the largest order. The displayed size determines the priority of allocation. If there are two or more resting orders or quotes at the same price, the System allocates contracts beginning with the resting order or quote displaying the largest size proportionally according to displayed size, based on the total number of contracts displayed at that price.

Third Allocation Tier – Priority Customer, non-displayed, price time

Sell Order Trades with:

-Order2 20@8.00

Fourth Allocation Tier – non-Priority Customer, non-displayed, pro-rata

Sell Order trades with:

Order3 12@8.00

Order5 2@8.00

*The sell order had a size of 75 contracts. In this final allocation, there were still contracts to be allocated after the displayed size of all orders at that price has been executed. The remaining size from the incoming order is allocated proportionally according to remaining total size of each resting order at such price, beginning with the order which has the largest total size remaining.*

## 2. Priority Customer with no other interest

Priority Customer Buy 1 @ \$12.00

Priority Customer Sell 1 @ 8.00

*Sell order trades with resting buy order @ 8.00 pursuant to Section 10(c)(1)(A)*

## 3. Priority Customer with other interest present and displayed v. non-displayed

Primary Market Maker quote 10@8.00 x 10@12.00

Order1 Priority Customer Buy 1@8.00

Order2 Priority Customer Reserve Buy 25@8.00 (display qty = 5)

Order3 Priority Customer Reserve Buy 25@8.00 (display qty = 5)

Order4 Priority Customer Buy 25@8.00

Order5 Firm Reserve Buy 10 @ 8.00 (display qty = 5)

Sell 100 @ 8.00

*Sell order trades with: Priority Customer displayed, price-time*

-Order1 1@8.00

-Order2 5@8.00 (displayed only)

-Order3 5@8.00 (displayed only)

-Order4 25@8.00

*Non-Priority Customer displayed, Size Pro-Rata*

*In this case the Primary Market Maker is allocated the full quantity which is better than entitlement pursuant to Section 10(c)(1)(B)(i). The incoming sell order has only executed 36 of its 100 contracts; 64 remain. There are only 15 displayed contracts remaining (10 PMM and 5 Firm), so each of those displayed quantities are able to be completely filled.*

-Primary Market Maker quote 10@8.00  
-Order5 5@8.00 (displayed only)

*Priority Customer non-displayed, price-time*

-Order2 20@8.00 (non-displayed)  
-Order3 20@8.00 (non-displayed)

*Non-Priority Customer non-displayed, pro-rata*

-Order5 5@8.00  
Remaining Sell 4@8.00 rests on the order book

#### 4. Primary Market Maker allocation where it is 30% and with 5 lot include rounding

30% example below in #4  
5 lot:

Primary Market Maker quote 10@8.00 x 10@12.00 (at NBBO)  
Order1 Firm Sell 10 @ 12.00  
Order2 Firm Sell 10 @ 12.00

Buy 5@12.00

*Buy order trades with Primary Market Maker quote 5@12.00 pursuant to Section 10(c)(1)(B)(a)*

#### 5. Primary Market Maker's Size Pro-Rata share pursuant Section 10(c)(1)(E) ("All Other Remaining Interest")

Primary Market Maker quote 100@8.00 x 100@12.00 (at NBBO)  
Order1 Firm sell 100 @ 12.00  
Order2 Firm sell 100 @ 12.00  
MM quote 10@8.00 x 10@11.95  
Buy 110@12.00

*Buy order trades with: best price*  
-MM quote 10@11.95

*Final price, other interest Size Pro-Rata*

*Primary Market Maker is allocated the Size Pro-Rate quantity pursuant to Section 10(c)(1)(B)(i)(b). This allocation quantity was greater than 30% allocation pursuant to 10(c)(1)(B)(i)(a).*

- Primary Market Maker quote 34@12.00
- Order1 33@12.00
- Order2 33@12.00

#### 6. Primary Market Maker is Preferred Market Maker and gets Preferred Allocation

Primary Market Maker quote 100@8.00 x 100@12.00 (at NBBO)  
Order1 Firm sell 100@12.00  
MM1 Quote 100@8.00 x 100@12.00  
MM2 Quote 100@8.00 x 100@12.00

Buy order 100 @ 12.00, preferenced to Primary Market Maker

*Buy order trades with: Preferred Market Maker 40% priority share pursuant to Section 10(c)(1)(c)(i)(a).*

- Primary Market Maker quote 40@12.00

*Pro-rata with other interest:*

- Order1 20@12.00
- MM1 Quote 20@12.00
- MM2 Quote 20@12.00

#### 7. Primary Market Maker and Preferred Market Maker are not the same

Primary Market Maker quote 100@8.00 x 100@12.00 (at NBBO)  
Order1 Firm sell 100@12.00  
MM1 Quote 100@8.00 x 100@12.00 (at NBBO)  
MM2 Quote 100@8.00 x 100@12.00

Buy order 100 @ 12.00, preferenced to MM1

*Buy order trades with: Preferred Market Maker 40% priority share pursuant to Section 10(c)(1)(c)(i)(a).*

- MM1 Quote 40@12.00

*Pro-rata with other interest:*

- Primary Market Maker quote 20@12.00
- Order1 20@12.00
- MM2 Quote 20@12.00

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,<sup>19</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>20</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest. The Exchange's proposal to reorganize Options 3, Section 10, add additional context and provide for limitations in the Opening Process and the auctions is consistent with the Act because the additional organization and detail will bring greater transparency to the Exchange's rule. Proposed Options 3, Section 10(a)(ii) reflects the current System. This rule change does not amend the current System.

Specifically, with respect to zero-bid options series, indicating that Market Orders to sell which are submitted prior to the Opening Process and persist after the Opening Process will be posted at a price equal to the minimum trading increment as defined in Options 3, Section 3 will provide additional information to Members about the Exchange's current practice. The Exchange believes that providing Members with the anticipated outcome of submitting zero-bid Market Orders will remove impediments to and perfect the mechanism of a free and open market.

The Exchange proposes to replace the words "other Professional Orders and market maker quotes" with "other non-Priority Customer orders and Market Maker quotes." The Exchange believes that the term "non-Priority Customer" reduces any confusion regarding any reference to Professional Order or Professional Customer. Orders and quotes are counted

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

<sup>20</sup> 15 U.S.C. 78f(b)(5).

individually for purposes of allocation even if they are from the same market participant. This amendment is not a change to current System operations.

The Exchange's proposal to replace the term "best price" with "NBBO" is consistent with the Act because it will provide greater transparency to the allocation process. The best price in this case is the NBBO. The amendment to this term does not reflect a substantive change to the current System. With respect to a Primary Market Maker's quote, the quote will not be executed at a price that trades through another market or displayed at a price that would lock or cross another market. The "NBBO" is the best Protected Bid and Protected Offer as defined in the Options Order Protection and Locked/Crossed Markets Plan; Protected Bids and Protected Offers that are displayed at a price but available on the Exchange at a better non-displayed price shall be included in the NBBO at their better non-displayed price for purposes of this rule.<sup>21</sup>

Providing a more detailed description of the manner in which the System applied Size Pro-Rata allocation in the current rule text, which is not currently contained in current Options 3, Section 10, is consistent with the Act because expanding upon the Exchange's current practice will further detail for Members the manner in which allocation occurs in the System. The Exchange's proposal is not intended to change the Exchange's allocation methodology, rather the Exchange is proposing to make clear the manner in which allocation is structured within the System. Further the Exchange's proposal to describe the manner in which orders are allocated to various types of market participants by category of participant and the possible outcomes if multiple allocations apply is consistent with the Act because understanding the potential outcomes protects investors and the public interest by increasing transparency. The Exchange's

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<sup>21</sup> See 17 CFR 242.600(b)(43).

proposal to relocate current rule text into the current rule and provide additional detail including limitations for Preferred Market Maker participation entitlements during the Opening Process and limitations on allocations of Orders of 5 Contracts or Fewer during the Opening Process and auctions will increase transparency for the protection of investors and the public interest. These limitations exist today. Finally, the Exchange believes that including all potential scenarios for allocation Orders of 5 Contracts or Fewer more clearly explains the Exchange's current allocation process. The Exchange believes that providing more detail benefits investors and the public interest.

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 not necessary or appropriate in furtherance of the purposes of the Act. The Exchange's proposal does not amend the current manner in which the Exchange allocates interest among market participants. The amendments to the rule reflect the manner in which the current System operates. The Exchange notes that Priority Customers will continue to be afforded certain allocation rights which are not available to other market participants. This is the case today. Primary Market Makers and Preferred Market Makers will continue to be afforded certain entitlements because of the continuing obligations they are bound to with respect to provide liquidity and quoting on the Exchange.<sup>22</sup> The Exchange notes that other market participants will continue to be allocated in the same manner as they are today on a Size Pro-Rata basis after other entitlements have been allocated. The Exchange believes the proposed rule provides more detail and offers more transparency into the allocation process.

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<sup>22</sup> See GEMX Rule Options 2, Section 3.



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

No written comments were either solicited or received.

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>23</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>24</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

IV. Solicitation of Comments

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

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<sup>23</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>24</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-GEMX-2019-10 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-GEMX-2019-10. 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 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-GEMX-2019-10 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>25</sup>

Jill M. Peterson  
Assistant Secretary

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<sup>25</sup> 17 CFR 200.30-3(a)(12).