

*Required fields are shown with yellow backgrounds and asterisks.*

Filing by International Securities Exchange  
 Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

<b>Initial *</b>	<b>Amendment *</b>	<b>Withdrawal</b>	<b>Section 19(b)(2) *</b>	<b>Section 19(b)(3)(A) *</b>	<b>Section 19(b)(3)(B) *</b>
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
			Rule		
<b>Pilot</b>	<b>Extension of Time Period for Commission Action *</b>	<b>Date Expires *</b>	<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
<input type="checkbox"/>	<input type="checkbox"/>	<input type="text"/>	<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

<b>Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010</b>	<b>Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934</b>
<b>Section 806(e)(1) *</b>	<b>Section 806(e)(2) *</b>
<input type="checkbox"/>	<input type="checkbox"/>
	<b>Section 3C(b)(2) *</b>
	<input type="checkbox"/>

<b>Exhibit 2 Sent As Paper Document</b>	<b>Exhibit 3 Sent As Paper Document</b>
<input type="checkbox"/>	<input type="checkbox"/>

**Description**

Provide a brief description of the action (limit 250 characters, required when Initial is checked \*).

Proposal to amend various rules in connection with a system migration to Nasdaq INET technology.

**Contact Information**

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name \*  Last Name \*   
 Title \*   
 E-mail \*   
 Telephone \*  Fax

**Signature**

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

(Title \*)

Date    
 By

(Name \*)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFF website.

**Form 19b-4 Information \***

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change \***

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies \***

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

(a) The International Securities Exchange, LLC (“ISE” or “Exchange”), 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> is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposal to amend various rules in connection with a system migration to Nasdaq INET technology.

A notice of the proposed rule change for publication in the Federal Register is at Exhibit 1 and the text of the amended Exchange Rule is at Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Board of Directors of the Exchange on November 10, 2016. No other action is necessary for the filing of the rule change.

Questions and comments on the proposed rule change may be directed to:

Angela Saccomandi Dunn  
Principal Associate General Counsel  
Nasdaq, Inc.  
215-496-5692

Adrian Griffiths  
Assistant General Counsel  
International Securities Exchange, LLC  
212-897-8176

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

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

Sun Kim  
Assistant General Counsel  
International Securities Exchange, LLC  
212-897-0238

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

a. Purpose

The purpose of this rule change is to amend certain rules to reflect the ISE technology migration to a Nasdaq, Inc. ("Nasdaq") supported architecture. INET is the proprietary core technology utilized across Nasdaq's global markets and utilized on The NASDAQ Options Market LLC ("NOM"), NASDAQ PHLX LLC ("Phlx") and NASDAQ BX, Inc. ("BX") (collectively, "Nasdaq Exchanges"). The migration of ISE to the Nasdaq INET architecture would result in higher performance, scalability, and more robust architecture. With this system migration, the Exchange intends to adopt certain trading functionality currently utilized at Nasdaq Exchanges. The functionality being adopted is described in this filing.

The Exchange is also separately filing<sup>3</sup> a rule change to amend the Exchange's Opening Process. ISE will replace its current opening process at Rule 701 with Phlx's Opening Process.<sup>4</sup>

The Exchange intends to begin implementation of the proposed rule changes in Q2 2017. The migration will be on a symbol by symbol basis, and the Exchange will

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<sup>3</sup> See SR-ISE-2017-02 (not yet published).

<sup>4</sup> See Phlx Rule 1017. See also Securities Exchange Act Release No. 79274 (November 9, 2016), 81 FR 80694 (November 16, 2016) (SR-Phlx-2017-79) (notice of Filing of Partial Amendment No. 2 and Order Granting Approval of a Proposed Rule Change, as Modified by Partial Amendment No. 2, to Amend PHLX Rule 1017, Openings in Options).

issue an alert to members in the form of an Options Trader Alert to provide notification of the symbols that will migrate and the relevant dates.

### **Generally**

With the re-platform, the Exchange will now be built on the Nasdaq INET architecture, which allows certain trading system functionality to be performed in parallel. The Exchange believes that this architecture change will improve the member experience by reducing overall latency compared to the current ISE system because of the manner in which the system is segregated into component parts to handle processing.

### **Trading Halts**

#### **Cancellation of Quotes**

The Exchange proposes to amend ISE Rule 702 entitled “Trading Halts.” Specifically, the Exchange proposes to amend Rule 702(a)(2) to note that during a halt, the Exchange will maintain existing orders on the book, but not existing quotes prior to the halt, accept orders and quotes, and process cancels and modifications for quotes and orders, except that existing quotes are cancelled. Today, ISE maintains existing orders and quotes during a trading halt. With respect to cancels and modifications, this behavior will not change. ISE does not have a quote purge today, so this functionality will be changed with the adoption of this trading rule. The Exchange believes that purging quotes upon a halt will remove uncertainty for market participants.

The Exchange proposes to conform the treatment of quotes and orders on ISE to Phlx Rule 1047(f) in conjunction with the replatform of ISE. The Exchange desires to handle halts in a similar manner as Phlx.

### **Limit Up-Limit Down**

The Exchange also proposes to add new ISE Rule 702(d) to replace rule text currently contained in ISE Rule 703A entitled “Trading During Limit Up-Limit Down States in Underlying Securities.” Proposed ISE Rule 702(d) is similar to language currently in Phlx Rule 1047, entitled “Trading During Limit Up-Limit Down States in Underlying Securities.” Proposed ISE Rule 702(d) is similar to language currently in Phlx Rule 1047(d), which provides for Exchange handling due to extraordinary market volatility. Currently ISE Rule 703A(a) and (b) provides modified order handling procedures when a security underlying an options class traded on the Exchange enters a Limit State or Straddle State under the Plan to Address Extraordinary Market Volatility (the “Plan”).<sup>5</sup> Specifically, during a Limit State or Straddle State: (1) incoming Market

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<sup>5</sup> Unless otherwise specified, capitalized terms used in this rule filing are based on the defined terms of the Plan. As set forth in more detail in the Plan, Price Bands consisting of a Lower Price Band and an Upper Price Band for each NMS Stock are calculated by the Processors (Section V(A) of the Plan). When the National Best Bid (Offer) is below (above) the Lower (Upper) Price Band, the Processors shall disseminate such National Best Bid (Offer) with an appropriate flag identifying it as unexecutable. When the National Best Bid (Offer) is equal to the Upper (Lower) Price Band, the Processors shall distribute such National Best Bid (Offer) with an appropriate flag identifying it as a Limit State Quotation (Section VI(A) of the Plan). All trading centers in NMS stocks must maintain written policies and procedures that are reasonably designed to prevent the display of offers below the Lower Price Band and bids above the Upper Price Band for NMS stocks. Notwithstanding this requirement, the Processor shall display an offer below the Lower Price Band or a bid above the Upper Price Band, but with a flag that it is non-executable. Such bids or offers shall not be included in the National Best Bid or National Best Offer calculations (Section VI(A)(3) of the Plan). Trading in an NMS stock immediately enters a Limit State if the National Best Offer (Bid) equals but does not cross the Lower (Upper) Price Band (Section VI(B)(1) of the Plan). Trading for an NMS stock exits a Limit State if, within 15 seconds of entering the Limit State, all Limit State Quotations were executed or canceled in their entirety. If the market does not exit a Limit State within 15 seconds, then the Primary Listing Exchange would declare a five-minute trading pause pursuant to Section VII of the Plan, which would be applicable to all

Orders are automatically rejected, and all unexecuted Market Orders pending in the System are cancelled, and (2) incoming Stop Orders (which become Market Orders if elected) are automatically rejected, and unexecuted Stop Orders pending in the System cannot be elected and will be held until the end of the Limit State or Straddle State. In addition, ISE Rule 703A(c) provides that when the security underlying an option class is in a Limit State or Straddle State, the maximum quotation spread requirements for market maker quotes contained in ISE Rule 803(b)(5) and the continuous quotation requirements contained in ISE Rule 804(e) shall be suspended.<sup>6</sup>

With the re-platform, the Exchange will adopt opening limitation, Market Order and Stop Order handling consistent with handling today on Phlx.<sup>7</sup> Specifically, proposed ISE Rule 702(d) will provide that during a Limit State and Straddle State in the Underlying NMS stock: (i) the Exchange will not open an affected option, (ii) provided

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markets trading the security. The primary listing market would declare a Trading Pause in an NMS stock; upon notification by the primary listing market, the Processor would disseminate this information to the public. No trades in that NMS stock could occur during the trading pause, but all bids and offers may be displayed (Section VII(A) of the Plan). In addition, the Plan defines a Straddle State as when the National Best Bid (Offer) is below (above) the Lower (Upper) Price Band and the NMS stock is not in a Limit State. For example, assume the Lower Price Band for an NMS Stock is \$ 9.50 and the Upper Price Band is \$ 10.50, such NMS stock would be in a Straddle State if the National Best Bid were below \$ 9.50, and therefore unexecutable, and the National Best Offer were above \$ 9.50 (including a National Best Offer that could be above \$ 10.50). If an NMS stock is in a Straddle State and trading in that stock deviates from normal trading characteristics, the Primary Listing Exchange may declare a trading pause for that NMS stock if such Trading Pause would support the Plan's goal to address extraordinary market volatility.

<sup>6</sup> The time periods associated with Limit States and Straddle States are not considered by the Exchange when evaluating whether a market maker complied with the continuous quotation requirements contained in Rule 804(e).

<sup>7</sup> See proposed ISE Rule 702(d)(ii) and (iii).

the Exchange has opened an affected option for trading, the Exchange shall reject Market Orders,<sup>8</sup> as defined in ISE Rule 715(a), and shall notify Members of the reason for such rejection, and (iii) provided the Exchange has opened an affected option for trading, the Exchange will elect Stop Orders if the condition is met, and, because they become Market Orders, shall cancel them back and notify Members of the reason for such rejection. The language in proposed ISE Rule 703(d)(iv) concerning the maximum quotation spread requirements for market maker quotes and the continuous quotation requirements suspensions are the same language currently contained in ISE Rule 703A(c).

These amendments differ in certain respects from the manner in which ISE operates today during a Limit State or Straddle State. The current ISE rule does not address the opening. The Exchange proposes to adopt rule text to provide for how the Exchange shall treat the opening rotation.<sup>9</sup> The opening in an option will not commence in the event that the underlying NMS stock is open, but has entered into a Limit State or Straddle State. If this occurs, the opening will only commence and complete if the underlying NMS stock stays out of a Limit or Straddle State. Accordingly, proposed ISE Rule 702(d)(i) will provide that the Exchange will not open an affected option. As a result, if an opening process is occurring, it will cease and then start the opening process from the beginning once the Limit State or Straddle State is no longer occurring.

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<sup>8</sup> This includes complex orders as well as single leg orders. The Exchange shall cancel complex orders that are Market Orders residing in the System if they are about to be executed by the System.

<sup>9</sup> See note 3 above.



In addition, ISE currently cancels Market Orders pending in the System upon initiation of a Limit or Straddle State. Under the proposal to adopt the Phlx rule and implementation of the Limit Up-Limit Down procedures, Market Orders pending in the System will continue to be processed regardless of the Limit or Straddle State. The Exchange believes this is a reasonable handling of Market Orders in the system since these orders are only pending in the System if they are exposed at the NBBO pursuant to Supplementary Material .02 to ISE Rule 1901 or a complex order exposed for price improvement pursuant to ISE Rule 722(b)(3)(iii). In both cases, if at the end of the exposure period the affected underlying is in a Limit or Straddle State, the Market Order will be cancelled with no execution occurring. If at the end of the exposure period the underlying is no longer in a Limit or Straddle State, the Market Order will be handled under the normal operation of the rules.

Lastly, ISE does not currently elect Stop Orders that are pending in the System during a Limit or Straddle State. Under the proposal, and in-line with the Phlx implementation, Stop Orders that are pending in the System during a Limit or Straddle State will be elected, if conditions for such election are met, however because they become Market Orders will be cancelled back to the Member with a reason for such rejection.

While the implementation of Market and Stop Order handling varies from ISE today, both the current and proposed Rule provide for protections from erroneous executions in a highly volatile period.<sup>10</sup> The Exchange believes consistency across the

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<sup>10</sup> The Exchange is introducing a Phlx protection, Acceptable Trade Range, into ISE Rules as discussed within this rule change.

six options markets operated by Nasdaq, Inc. provides clarity for Members as to how their orders, as well as the opening process, will be handled in a Limit or Straddle State.

### **Auction Handling During a Trading Halt**

The Exchange proposes to amend various rules to add detail to ISE rules to account for the impact of a trading halt on the Exchange's auction mechanisms. The Exchange proposes to memorialize within ISE Rule 723, entitled "Price Improvement Mechanism for Crossing Transactions" the manner in which a trading halt will impact an order entered into PIM once it is migrated to the INET architecture.

Today, if a trading halt is initiated after a single leg order is entered into the Price Improvement Mechanism ("PIM") on ISE, such auction is terminated and eligible interest is executed or in the case of a complex order entered into PIM, the auction is terminated and eligible interest is cancelled without execution. The Exchange is amending the behavior with respect to single leg orders in PIM auctions to terminate the auction and not execute eligible interest when a trading halt occurs. In the event of a trading halt, terminating the auction and not executing eligible interest will provide certainty to participants in regard to how their interest will be handled. Introducing consistent order handling, regardless of single leg or complex, and memorializing the manner in which the system will handle all orders entered into PIM during a trading halt will provide transparency for the benefit of members and investors. The Exchange is not amending the behavior with respect to complex orders in PIM auctions.

The Exchange proposes an amendment to ISE Rule 716, entitled "Block Trades" to memorialize that if a trading halt is initiated after an order is entered into the Block Order Mechanism, Facilitation Mechanism, or Solicited Order Mechanism, such auction

will also be automatically terminated without execution. This is the current behavior today on ISE and will not be changing.

As discussed above, Phlx Rule 1047(c) provides that in the event the Exchange halts trading, all trading in the affected option shall be halted. This is interpreted to restrict executions after a halt unless there is a specific rule specifying that such trades should take place. The Exchange is proposing to add more specificity into the relevant rules. With respect to Block Order Mechanism, Facilitation Mechanism, or Solicited Order Mechanism, the Exchange notes that the current behavior is consistent with Phlx Rule 1047(c) generally, where all trading in the affected option shall be halted.<sup>11</sup> In the event of a trading halt, terminating these auction mechanisms and not executing eligible interest will provide certainty to participants in regard to how their interest will be handled. Memorializing the manner in which the system will handle orders during a trading halt will provide transparency for the benefit of members and investors.

### **Market Order Spread Protection**

The Exchange proposes to amend ISE Rule 711, entitled “Acceptance of Quotes and Orders” to adopt a new mandatory risk protection entitled Market Order Spread Protection which will apply to single leg Market Orders. ISE does not have a similar feature today. This mandatory feature is currently offered on NOM to protect Market Orders from being executed in very wide markets.<sup>12</sup>

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<sup>11</sup> See Phlx Rule 1047(c).

<sup>12</sup> See NOM Rules at Chapter VI, Section 6(c). NOM’s current rule states, “System Orders that are Market Orders will be rejected if the *best of the* NBBO and the internal market BBO (the “Reference BBO”) is wider than a preset threshold at the time the order is received by the System.” NOM has two order types, Price-Improving and Post-Only Orders, which result in non-displayed pricing that may

Pursuant to proposed ISE Rule 711(c), if the NBBO is wider than a preset threshold at the time a Market Order is received, the order will be rejected. For example, if the Market Order Spread Protection is set to \$20.00, and a Market Order to buy is received while the NBBO is \$1.00 - \$50.00, such Market Order will be rejected. The proposed feature would assist with the maintenance of fair and orderly markets by mitigating the risks associated with errors resulting in executions at prices that are away from the Best Bid or Offer and potentially erroneous. Further the proposal protects investors from potentially receiving executions away from the prevailing prices at any given time. The Exchange proposes this feature to avoid a series of improperly priced aggressive orders transacting in the Order Book.

Today, the NOM threshold is set at \$5. ISE will initially set the threshold to \$5. Similar to NOM, the Exchange will notify Members of the threshold with a notice, and, thereafter, Members will be notified of any subsequent changes to the threshold. NOM set the differential at \$5 to match the bid/ask differential permitted for quotes on the Exchange.<sup>13</sup> ISE has a similar \$5 differential.<sup>14</sup> Thus, the presence of a quote on the

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cause the internal market BBO to be better than the NBBO. ISE does not have similar non-displayed order types and therefore the reference to the internal market BBO is not necessary.

<sup>13</sup> See Chapter VII, Section 6(d)(ii) of NOM Rules which describes the bid/ask differentials. Options on equities (including Exchange-Traded Fund Shares), and on index options must be quoted with a difference not to exceed \$5 between the bid and offer regardless of the price of the bid, including before and during the opening. However, respecting in-the-money series where the market for the underlying security is wider than \$5, the bid/ask differential may be as wide as the quotation for the underlying security on the primary market. The Exchange may establish differences other than the above for one or more series or classes of options.

<sup>14</sup> See ISE Rule 803(b)(4).

Exchange will ensure the NBBO is at least \$5 wide. The Exchange believes the presence of a quote on the Exchange, or a bid/ask differential of the NBBO, which is no more than \$5 wide affords Market Orders proper protection against erroneous execution and in the event a bid/ask differential is more than \$5, then a Market Order is rejected. The threshold is appropriate because it seeks to capture improperly priced Market Orders and reject them to reduce the risk of, and to potentially prevent, the automatic execution of Market Orders at prices that may be considered erroneous. The Exchange's proposed threshold is a reasonable measure to ensure prices remain within the reasonable limits. This protection will bolster the normal resilience and market behavior that persistently produces robust reference prices. This feature should create a level of protection that prevents Market Orders from entering the Order Book outside of an acceptable range for the Market Order to execute.

Finally, the Market Order Spread Protection will be the same for all options traded on the Exchange, and is applicable to all Members that submit Market Orders.

### **Acceptable Trade Range**

The Exchange proposes to amend ISE Rule 714, entitled "Automatic Execution of Orders," at ISE Rule 714(b)(1) to adopt Phlx's Acceptable Trade Range for single leg orders.<sup>15</sup> The Exchange is proposing to adopt similar functionality which is currently

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<sup>15</sup> See Phlx Rule 1080(p). Today, ISE places a limit on the number of price levels at which an incoming order or quote to sell (buy) will be executed automatically for single leg and complex orders when there are no bids (offers) from other exchanges at any price for the options series. Orders and quotes are executed at each successive price level until the maximum number of price levels is reached, and any balance is either handled by the Primary Market Maker pursuant to Rule 803(c)(1) (in the case of Priority Customer Orders) or canceled (in the case of Professional Orders). The number of price levels, may be between one (1) and

utilized on Phlx in connection with the replatform of ISE for single leg orders. Today, ISE places a limit on the number of price levels at which an incoming order or quote to sell (buy) will be executed automatically when there are no bids (offers) from other exchanges at any price for the options series. Orders and quotes are executed at each successive price level until the maximum number of price levels is reached, and any balance is either handled by the Primary Market Maker pursuant to Rule 803(c)(1) (in the case of Priority Customer Orders) or canceled (in the case of Professional Orders). The number of price levels, may be between one (1) and ten (10). The Exchange determines the number of price levels from time-to-time on a class-by-class basis.

ISE proposes to replace the current Price Level Protection applied to single leg orders with Phlx's Acceptable Trade Range.<sup>16</sup> The proposed Acceptable Trade Range is a mechanism to prevent the system from experiencing dramatic price swings by creating a level of protection that prevents the market from moving beyond set thresholds. The thresholds consist of a reference price plus (minus) set dollar amounts based on the nature of the option and the premium of the option.

The system will calculate an Acceptable Trade Range to limit the range of prices at which an order or quote will be allowed to execute. To bolster the normal resilience and market behavior that persistently produces robust reference prices, ISE is proposing to create a level of protection that prevents the market from moving beyond set

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ten (10). The Exchange determines the number of price levels from time-to-time on a class-by-class basis. This proposal only impacts single leg orders.

<sup>16</sup> The Exchange notes that the version of Acceptable Trade Range to be implemented on ISE will not include the posting period functionality available today on Phlx. The proposed rules reflect this change.

thresholds. The Acceptable Trade Range is calculated (upon receipt of a new order or quote) by taking the reference price, plus or minus a value to be determined by the Exchange (i.e., the reference price - (x) for sell orders/quotes and the reference price + (x) for buy orders).<sup>17</sup> Upon receipt of a new order, the reference price is the National Best Bid (“NBB”) for sell orders/quotes and the National Best Offer (“NBO”) for buy orders/quotes. If an order or quote reaches the outer limit of the Acceptable Trade Range (the “Threshold Price”) without being fully executed, then any unexecuted balance will be cancelled. The proposed Acceptable Trade Range would work as follows: prior to executing orders received by ISE, an Acceptable Trade Range is calculated to determine the range of prices at which orders/quotes may be executed.<sup>18</sup> When an order is initially received, the threshold is calculated by adding (for buy orders/quotes) or subtracting (for sell orders/quotes) a value,<sup>19</sup> as discussed below, to the National Best Offer for buy orders/quotes or the National Best Bid for sell orders/quotes to determine the range of prices that are valid for execution. A buy (sell) order or quote will be allowed to execute up (down) to and including the maximum (minimum) price within the Acceptable Trade Range.

For example, in a thinly traded option:

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<sup>17</sup> The Acceptable Trade Range settings are tied to the option premium.

<sup>18</sup> The Acceptable Trade Range will not be available for all-or-none orders. Today, ISE’s Price Level Protection rule is not available for all-or-none orders. The Exchange has determined that it would be difficult, from a technical standpoint, to apply this feature to those orders because their particular contingency makes it difficult to automate their handling.

<sup>19</sup> The value that is to be added to/subtracted from the reference price will be set by ISE and posted on its website.

## Away Exchange Quotes:

Exchange	Bid Size	Bid Price	Offer Price	Offer Size
NOM	10	\$1.00	\$1.05	10
NYSE Arca	10	\$1.00	\$1.05	10
NYSE MKT	10	\$1.00	\$1.10	10
BOX	10	\$1.00	\$1.15	10

## ISE Price Levels:

Exchange	Bid Size	Bid Price	Offer Price	Offer Size
ISE orders	10	\$1.00	\$1.05	10
ISE orders			\$1.10	10
ISE orders			\$1.40	10
ISE orders			\$5.00	10

If ISE receives a routable market order to buy 80 contracts, the System will respond as described below:

- 10 contracts will be executed at \$1.05 against ISE
- 10 contracts will be executed at \$1.05 against NOM
- 10 contracts will be executed at \$1.05 against NYSE Arca.
- 10 contracts will be executed at \$1.10 against ISE
- 10 contracts will be executed at \$1.10 against NYSE MKT
- 10 contracts will be executed at \$1.15 against BOX

After these executions, there are no other known valid away exchange quotes. The National Best Bid/Offer (“NBBO”) is therefore comprised of the remaining interest on the ISE book, specifically 10 contracts at \$1.40 and 10 contracts at \$5.00. In the absence



of an Acceptable Trade Range mechanism, the order would execute against the remaining interest at \$1.40 and \$5.00, resulting in potential harm to investors.

ISE will set the parameters of the mechanism at levels that will ensure that it is triggered quite infrequently. Importantly, the Acceptable Trade Range is neutral with respect to away markets, an order may route to other destinations to access liquidity priced within the Acceptable Trade Range provided the order is designated as routable.

The options premium will be the dominant factor in determining the Acceptable Trade Range. Generally, options with lower premiums tend to be more liquid and have tighter bid/ask spreads; options with higher premiums have wider spreads and less liquidity. Accordingly, a table consisting of several steps based on the premium of the option will be used to determine how far the market for a given option will be allowed to move. This table or tables would be listed on the NASDAQTrader.com website and any periodic updates to the table would be announced via an Options Trader Alert.

For example, looking at some SPY May 2013 Call options on May 1st of 2013:

Bid/Offer of SPY May 160 Call (at or near-the-money): \$1.23 x \$1.24 (several hundred contracts on bid and offer)

Bid/Offer of SPY May 105 Call (deep in-the-money): \$54.10 x \$54.26 (11 contracts on each side)

The deep in-the-money calls (May 105 calls) have a wider spread ( $\$54.10 - \$54.26 = \$0.16$ ) compared to a spread of \$0.01 for the at-the-money calls (May 160 calls).

Therefore, it is appropriate to have different thresholds for the two options. For instance, it may make sense to have a \$0.05 threshold for the at-the-money strikes (Premium < \$2) and a \$0.50 threshold for the deep in-the-money strikes (Premium > \$10).

To consider another example, the May 2013 ORCL put options on May 1st of 2013:

Bid/Offer of ORCL 33 May Put (at or near-the-money): \$0.33 x \$0.34 (100x500)  
Bid/Offer of ORCL 44 May Put (deep in-the-money): \$10.40 x \$10.55 (50 x 200)  
Even though ORCL has a much lower share price than SPY, and is a different type of security (it is a common stock of a technology company whereas SPY is an ETF based on the S&P 500 Index), the pattern is the same. The option with the lower premium has a very narrow spread of \$0.01 with significant size displayed whereas the higher premium option has a wide spread (\$0.15) and less size displayed.

The Acceptable Trade Range settings will be tied to the option premium. However, other factors will be considered when determining the exact settings. For example, acceptable ranges may change if market-wide volatility is as high as it was during the financial crisis in 2008 and 2009, or if overall liquidity is low based on historical trends. These different market conditions may present the need to adjust the threshold amounts from time to time to ensure a well-functioning market. Without adjustments, the market may become too constrained or conversely, prone to wide price swings. As stated above, the Exchange would publish the Acceptable Trade Range table or tables on the Exchange website. The Exchange does not foresee updating the table(s) often or intraday, although the exchange may determine to do so in extreme circumstances. The Exchange will provide sufficient advanced notice of changes to the Acceptable Trade Range table, generally the prior day, to its membership via an Exchange alert.

The Acceptable Trade Range settings would generally be the same across all options traded on ISE, although ISE proposes to maintain flexibility to set them

separately based on characteristics of the underlying security. For instance, Google is a stock with a high share price (\$824.57 closing price on April 30, 2013). Google options therefore may require special settings due to the risk involved in actively quoting options on such a high-priced stock. Option spreads on Google are wider and the size available at the best bid and offer is smaller. Google could potentially need a wider threshold setting compared to other lower-priced stocks. There are other options that fit into this category (e.g., AAPL) which makes it necessary to have threshold settings that have flexibility based on the underlying security. Additionally, it is generally observed that options subject to the Penny Pilot program quote with tighter spreads than options not subject to the Penny Pilot. Currently, ISE expects to set Acceptable Trade Ranges for three categories of options: (1) Penny Pilot Options trading in one cent increments for options trading at less than \$3.00 and increments of five cents for options trading at \$3.00 or more, (2) Penny Pilot Options trading in one-cent increments for all prices, and (3) Non-Penny Pilot Options.

The Phlx rule contains language that references a posting period.<sup>20</sup> Specifically, the Phlx Rule provides if an order/quote reaches the outer limit of the Acceptable Trade Range (the “Threshold Price”) without being fully executed, it will be posted at the Threshold Price for a brief period, not to exceed one second (“Posting Period”), to allow more liquidity to be collected, unless a Quote Exhaust has occurred, in which case the Quote Exhaust process in Phlx Rule 1082(a)(ii)(B)(3) will ensue, triggering a new

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<sup>20</sup> See Phlx Rule 1080(p)(1)(B).

Reference Price.<sup>21</sup> The Exchange will not post interest that exceeds the outer limit of the Acceptable Trade Range, rather the interest will be cancelled. Only if the order limit does not exceed the Acceptable Trade Range will it post on the Exchange, if not otherwise executed. Further, the Phlx rule provides for the re-pricing of that order or quote and calculation of a new Acceptable Trade Range. Consistent with the current treatment of orders and quotes under ISE rules, the Exchange is not adopting the posting period. Unlike Phlx, ISE does not offer a general continuous re-pricing mechanism, and does not consider iterations in its current functionality.<sup>22</sup> ISE would cancel rather than reprice orders which exceed the outer limit of the Acceptable Trade Range. Orders which do not exceed the outer limit of the Acceptable Trade Range will post to the order book and will reside on the order book at such price until they are either executed in full or cancelled by the Member. Additionally, resting orders do not re-price on the order book as they do today on Phlx. For these reasons, the unexecuted balance which exceeds

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<sup>21</sup> The Quote Exhaust process occurs when the Exchange's disseminated market at a particular price level includes a quote, and such market is exhausted by an inbound contra-side quote or order, and following such exhaustion, contracts remain to be executed from such quote or order through the initial execution price.

<sup>22</sup> With respect to trade-throughs and locked and crossed markets, a Phlx order will not be executed at a price that trades through another market or is displayed at a price that would lock or cross another market. If, at the time of entry, an order that the entering party has elected not to make eligible for routing would cause a locked or crossed market violation or would cause a trade-through violation, it will be re-priced to the current national best offer (for bids) or the current national best bid (for offers) and displayed at one minimum price variance above (for offers) or below (for bids) the national best price. See Phlx Rule 1080(m)(iv)(A). In the instance that the System automatically reprices an order or quote, the System would assign the orders or quote a new timestamp and the order or quote will be reprioritized within the Order Book in accordance with the priority rules in Phlx Rule 1014 (g).

the outer limit of the Acceptable Trade Range will be cancelled, rather than posted to the order book.

For complex orders, the Exchange will continue to apply the Price Level Protection Rule which is being relocated to Rule 714(b)(4) and revised to specifically state that the Price Level Protection shall apply to complex orders. The functionality will remain the same. The Exchange is amending the current rule to remove references that specifically related to single leg order functionality. Primary Market Maker handling does not apply to complex orders and therefore is being removed from the rule text. The Exchange is also adding references to component legs to make clear the application to complex orders. Unlike single leg orders which are subject to trade-through protections, complex orders do not have similar restrictions and therefore the Exchange believes that the current Price Level Protection Rule provides a better protection for complex orders because the Acceptable Trade Range protection described within this filing utilizes the NBBO and the Price Level Protection does not rely on the NBBO but rather limits the number of price levels.

### **PMM Order Handling and Opening Obligations**

Today, PMMs are responsible for handling Priority Customer orders that are not automatically executed pursuant to ISE Rule 714(b)(1), i.e., the Price Level Protection, and to initiate the opening rotation in each series pursuant to ISE Rule 701. This responsibility is described in each of those rules, as well as in ISE Rule 803(c), which provides that:

In addition to the obligations contained in this Rule for market makers generally, for options classes to which a market maker is the appointed Primary Market Maker, it shall have the responsibility to: (1) As soon as practical, address Priority Customer Orders that are not automatically executed pursuant to Rule 714(b)(1) in a manner consistent with its obligations under paragraph (b) of this Rule by

either (i) executing all or a portion of the order at a price that at least matches the NBBO and that improves upon the Exchange's best bid (in the case of a sell order) or the Exchange's best offer (in the case of a buy order); or (ii) releasing all or a portion of the order for execution against bids and offers on the Exchange. (2) Initiate trading in each series pursuant to Rule 701.

As described in more detail in the sections above, with the re-platform to Nasdaq technology, the Exchange is adopting Acceptable Trade Range and opening rotation functionality currently offered on NOM and Phlx, which do not contain similar requirements for the PMM. The Exchange therefore proposes to eliminate the PMM order handling and opening obligations in Rule 803(c).

The Exchange believes that the elimination of the PMM obligation to initiate the opening rotation in this rule is appropriate because the proposed opening process<sup>23</sup> is initiated by the receipt of an appropriate number of valid width Primary Market Maker or Competitive Market Maker quotes as outlined in proposed ISE Rule 701(c)(i). Similarly, the Acceptable Trade Range functionality will continue to provide an important protection to members without imposing any Primary Market Maker obligations. Today, Phlx does not have similar roles for a Specialist on its market. In connection with the replatform, the Exchange will conform its rules with those of Phlx with respect to the manner in which it operates the Opening Process.

### **Back-Up PMM**

The Exchange also proposes to amend ISE Supplementary Material .03 to Rule 803 to eliminate its Back-Up Primary Market Maker program. Today, any ISE Member that is approved to act in the capacity of a Primary Market Maker may voluntarily act as a "Back-Up Primary Market Maker" in options series in which it is quoting as a

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<sup>23</sup> See note 3 above.

Competitive Market Maker. A Back-Up Primary Market Maker assumes all of the responsibilities and privileges of a Primary Market Maker under the Exchange's rules with respect to any series in which the appointed Primary Market Maker fails to have a quote in the System except that a Back-Up Primary Market Maker's quoting obligations are the same as the quoting obligations for Competitive Market Makers as described in ISE Rule 804(e)(2)(iii) and .02 of Supplementary Material to Rule 804.<sup>24</sup> If more than one Competitive Market Maker that has volunteered to be a Back-Up Primary Market Maker is quoting in an options series at the time that a Primary Market Maker ceases quoting, the Competitive Market Maker with the largest offer at the lowest price in the series at that time will be chosen to be the Back-Up Primary Market Maker. In the event of a tie based on price and size, the Competitive Market Maker with time priority will be automatically chosen. The Back-Up Primary Market Maker is automatically restored to Competitive Market Maker status when the appointed Primary Market Maker initiates quoting in the series. The obligations of a Primary Market Maker include the initiation of a trading rotation pursuant to ISE Rule 701, quoting and other obligations pursuant to ISE Rules 803 and 804, and financial requirements pursuant to ISE Rule 809. The Exchange is proposing to amend the obligations of a PMM only with regard to the initiation of a trading rotation pursuant to ISE Rule 701. The quoting and financial requirements rules shall remain the same.

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<sup>24</sup> The Exchange notes that the current rule text for Back-up Primary Market Maker on ISE does not indicate that quoting obligations for Back-up Primary Market Makers are the same as for Competitive Market Makers. This, however, has been the Exchange's practice. See Securities Exchange Act Release No. 76936 (January 20, 2016), 81 FR 4347 (January 26, 2016) (SR-ISE-2016-02).

With the re-platform, a Back-Up Primary Market Maker is no longer necessary since the order handling obligations present on ISE today are not going to be present in the new system. Furthermore, the proposed Opening Process obviates the importance of such a role. The Opening Process describes the entry of quotes by both a Primary Market Maker and a Competitive Market Maker, provided they are Valid Width Quotes.<sup>25</sup> The Opening Process further describes alternative methods to open the market if such quotes are not entered at the opening by either of these market makers.<sup>26</sup> The reliance on a market maker to initiate the opening process is no longer present within the proposed rule.<sup>27</sup>

### **Market Maker Speed Bump**

The Exchange proposes to amend ISE Rule 804, entitled “Market Maker Quotations” to establish default parameters for certain risk functionality. The Exchange offers a risk protection mechanism for market maker quotes that removes a member’s quotes in an options class if a specified number of curtailment events occur during a set time period (“Market Maker Speed Bump”). In addition, the Exchange offers a market-wide risk protection that removes a market maker’s quotes across all classes if a number of curtailment events occur (“Market-Wide Speed Bump”).<sup>28</sup> ISE Rule 804(g) currently

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<sup>25</sup> A Valid Width Quote is a two-sided electronic quotation submitted by a Market Maker that consists of a bid/ask differential that is compliant with ISE proposed Rule 803(b)(4). See note 3 above.

<sup>26</sup> See note 3 above.

<sup>27</sup> Id.

<sup>28</sup> Market makers may request the Exchange to set the market wide parameter to apply to just ISE or across ISE and ISE Gemini.



requires that market makers set curtailment parameters for both the Market Maker Speed Bump and the Market-Wide Speed Bump. Today, if a market maker does not set these parameters their quotes are rejected by the trading system for each of the speed bumps mentioned herein.

With the re-platform, the Exchange has determined to provide default curtailment parameters to assist market makers when they do not enter their own parameters into the system. The default parameters will be determined by the Exchange and announced to members. Rather than rejecting quotes, the default parameters would be instituted. The default parameters are important because market makers at ISE have quoting obligations as specified in ISE Rule 804. When a market maker's quotes are removed from the system, the time does not count toward the continuous quoting obligations. The Exchange believes that allowing for default settings would cause quotes not to be rejected and would assist market makers in meeting their quoting obligations because they would not have their quotes removed from the market. Today, Phlx indicates default parameters for its detection of loss of communication settings.<sup>29</sup>

### **Anti-Internalization**

The Exchange proposes to amend the ISE Supplementary Material at .03 to Rule 804, entitled "Market Maker Quotations" to adopt Anti-Internalization rule. Today, ISE's functionality prevents Immediate-or-Cancel ("IOC")<sup>30</sup> orders entered by a market

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<sup>29</sup> Phlx Rule 1019(c).

<sup>30</sup> An IOC order is a limit order that is to be executed in whole or in part upon receipt. Any portion not so executed is to be treated as cancelled. See Rule 715(b)(3).

maker from trading with the market maker's own quote.<sup>31</sup> As implemented, if an IOC order entered by a market maker would trade with a quote entered by the same market maker, that order will instead be allocated to other interest at the same price, and the balance cancelled. The Exchange proposes to replace this self-trade protection functionality with Anti-Internalization functionality currently offered on Phlx.<sup>32</sup>

Today, Phlx provides anti-internalization ("AIQ") functionality to Specialists and Registered Options Traders ("collectively market makers"). Quotes and orders entered by Phlx market makers using the same badge<sup>33</sup> are not executed against quotes and orders entered on the opposite side of the market using the same badge. This automatically prevents these quotes and orders from interacting with each other in the System. On Phlx, the system cancels the resting quote or order back to the entering party prior to execution. This functionality does not apply in any auction or with respect to complex transactions.

The Exchange proposes to adopt a similar rule that provides that quotes and orders entered by Market Makers using the same member identifier will not be executed against quotes and orders entered on the opposite side of the market by the same market maker using the same member identifier. In such a case, the system will cancel the resting quote or order back to the entering party prior to execution. This functionality shall not apply in any auction or with respect to complex transactions. AIQ is difficult to apply during auctions, and there is limited benefit in doing so. There is limited benefit

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<sup>31</sup> This functionality is not memorialized in ISE's rules.

<sup>32</sup> See Phlx Rule 1080(p)(2).

<sup>33</sup> A badge is the same as a market participant identifier ("MPID").

because, generally speaking, auctions do not raise the same policy concerns for wash sales and ERISA<sup>34</sup> due to the semi-random manner in which trades are matched. AIQ is unnecessary with respect to complex orders due to the highly specialized nature of such orders and the high level of control that market participants exercise over complex orders.

This functionality does not relieve or otherwise modify the duty of best execution owed to orders received from public customers. Market Makers generally do not display public customer orders in market making quotations, opting instead to enter public customer orders using separate identifiers. In the event that a Market Maker opts to include a public customer order within a market making quotation, the Market Maker must take appropriate steps to ensure that public customer orders that do not execute due to anti-internalization functionality ultimately receive the same execution price (or better) they would have originally obtained if execution of the order was not inhibited by the functionality.

This Anti-Internalization functionality can assist Market Makers in reducing trading costs from unwanted executions potentially resulting from the interaction of executable buy and sell trading interest from the same firm when performing the same market making function.

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<sup>34</sup> AIQ also is designed to assist market participants in complying with certain rules and regulations of the Employee Retirement Income Security Act (“ERISA”) that preclude and/or limit managing broker-dealers of such accounts from trading as principal with orders generated for those accounts. It can also assist Market Makers in reducing trading costs from unwanted executions potentially resulting from the interaction of executable buy and sell trading interest from the same firm when performing the same market making function.

**Minimum Execution Quantity Orders**

The Exchange proposes to amend ISE Rule 715, entitled “Types of Orders” at 715(q) to remove minimum quantity orders. Today, the Exchange allows members to enter minimum quantity orders, which is an order type that is available for partial execution, but each partial execution must be for a specified number of contracts or greater. If the balance of the order after one or more partial executions is less than the minimum, such balance is treated as all-or-none. Like all-or-none orders, minimum quantity orders are contingency orders that are not displayed in the Exchange’s best bid or offer. However, the Exchange disseminates to market participants an indication that a minimum quantity order has been entered. The Exchange has found that the utilization of minimum quantity orders by its members has been very limited, and therefore proposes to remove this functionality.<sup>35</sup> Furthermore, the Exchange proposes to remove two references to minimum quantity orders in other rules. Specifically, the Exchange proposes to remove references to minimum quantity orders in ISE Supplementary Material .02 to Rule 713, which notes that minimum quantity orders are contingency orders that have no priority on the book, and in ISE Supplementary Material .04 to Rule 717, which explains that non-marketable minimum quantity orders are deemed “exposed” one second following a broadcast notifying the market that such an order to buy or sell a specified number of contracts at a specified with a specified minimum quantity has been received in the options series.

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<sup>35</sup> This functionality is currently being utilized to transact less than 1% of ISE’s volume.

**Delay of Implementation**

The Exchange proposes to delay the implementation of Directed Order<sup>36</sup> functionality on ISE. The Exchange proposes to continue to offer this functionality on the current platform. The Exchange however would propose not to launch the Directed Order functionality on ISE at the same time as proposed herein for the proposals to amend other trading functions. The Exchange would instead issue an alert which specifies a different date for this functionality to commence on ISE. This functionality will remain the same on the new platform.

The Exchange proposes to amend the rule text in Rule 811 (Directed Orders) to note that this functionality will not be available as of a certain date in the second quarter of 2017 to be announced in a notice. The Exchange will recommence this functionality on ISE within one year from the date of filing of this rule change to be announced in a separate notice.

The Exchange intends to begin implementation of the functionality for Directed Orders after Q2 2017. The migration will also be on a symbol by symbol basis, and the Exchange will issue an alert to members in the form of an Options Trader Alert to provide notification of the symbols that will migrate and the relevant dates. The Exchange will introduce Directed Orders on ISE within one year from the date of this

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<sup>36</sup> ISE currently operates a Directed Order system in which Electronic Access Members (“EAMs”) can send an order to a DMM for possible price improvement. If a DMM accepts Directed Orders generally, that DMM must accept all Directed Orders from all EAMs. Once such a DMM receives a Directed Order, it either (i) must enter the order into the Exchange’s PIM auction and guarantee its execution at a price better than the ISE best bid or offer (“ISE BBO”) by at least a penny and equal to or better than the NBBO or (ii) must release the order into the Exchange’s limit order book, in which case there are certain restrictions on the DMM interacting with the order. See ISE Rule 811.

filing, otherwise the Exchange will file a rule proposal with the Commission to remove these rules.

(b) Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>37</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>38</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 for the reasons stated below.

**Trading Halts**

The Exchange's proposal to amend ISE Rule 702 concerning Trading Halts to specifically note that during a halt the Exchange will maintain existing orders on the book but not existing quotes is consistent with the Act because it provides market participants with clarity as to the manner in which interest will be handled by the system. During a trading halt, the market may move and create risk to market participants with respect to resting interest. The Exchange believes that cancelling existing quotes protects investors and the public interest by removing potentially stale quotes during the halt process.

The Exchange's proposal to amend its rules on order handling during Limit up-Limit Down states and trading halts is consistent with the Act because it will harmonize the way the Exchange treats orders during a Limit State or Straddle State in the equity market, or a trading halt in the option, with how those orders are handled on other Nasdaq

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<sup>37</sup> 15 U.S.C. 78f(b).

<sup>38</sup> 15 U.S.C. 78f(b)(5).

Exchanges. The proposed rule text should provide certainty about how options orders and trades will be handled during periods of extraordinary volatility in the underlying security. Specifically, under the proposal, market participants will be able to continue to trade options overlying securities that are in a Limit State or Straddle State, while addressing specific order types that are subject to added risks during such periods. The Exchange believes that the rejection of options Market Orders (including elected Stop Orders) should help to prevent executions that might occur at prices that have not been reliably formed, which should, in turn, protect, in particular, retail investors from executions of un-priced orders during times of significant volatility. Specifically, with respect to Market Orders, Market Orders exposed at the NBBO pursuant to Supplementary Material .02 to ISE Rule 1901 or exposed for price improvement pursuant to ISE Rule 722(b)(3)(iii), which are pending in the system, will continue to be processed. The Exchange believes that it is consistent with the Act to cancel a Market Order, if at the end of either of these exposure periods the affected underlying is in a Limit or Straddle State, because of the uncertainty present which may result in executions that might occur at prices that have not been reliably formed. The Exchange would process the Market Order, with normal handling, provided the affected underlying is no longer in a Limit or Straddle State. The Exchange believes that this approach should, in turn, protect, in particular, retail investors from executions of un-priced orders during times of significant volatility. The Exchange believes that harmonizing these rules will provide a better experience to members that trade on multiple markets operated by Nasdaq, Inc.

### **Cancellation of Quotes**

The Exchange's proposal to amend ISE Rule 702 concerning Trading Halts to specifically note that during a halt the Exchange will maintain existing orders on the book but not existing quotes is consistent with the Act because it provides market participants with clarity as to the manner in which interest will be handled by the system. During a trading halt, the market may move and create risk to market participants with respect to resting interest. The Exchange believes that cancelling existing quotes protects investors and the public interest by removing potentially stale quotes during the halt process.

### **Limit Up-Limit Down**

The Exchange's proposal to add new ISE Rule 702(d) to replace rule text currently contained in ISE Rule 703A entitled "Trading During Limit Up-Limit Down States in Underlying Securities" is consistent with the Act because the proposed rules provide for protections from erroneous executions in a highly volatile period. The proposed rule text in ISE Rule 702(d) is similar to language currently in Phlx Rule 1047(d), which provides for Exchange handling due to extraordinary market volatility. As noted within this proposal, the Exchange will adopt opening limitation, Market Order and Stop Order handling consistent with handling today on Phlx. The Exchange proposes to adopt rule text to provide for how the Exchange shall treat the opening rotation.<sup>39</sup> If an opening process is occurring, it will cease and then start the opening process from the beginning once the Limit State or Straddle State is no longer occurring. The Exchange believes that this treatment at the opening will protect investors and the public interest by halting trading to prevent unintended executions. Also, with this proposal, Market

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<sup>39</sup> See note 3 above.



Orders pending in the System will continue to be processed regardless of the Limit or Straddle State. The Exchange believes that this treatment of Market Orders is consistent with the Act because these Market Orders are only pending in the System if they are exposed at the NBBO pursuant to Supplementary Material .02 to ISE Rule 1901 or a complex order exposed for price improvement pursuant to ISE Rule 722(b)(3)(iii). If at the end of the exposure period the affected underlying is in a Limit or Straddle State, the Market Order will be cancelled with no trade occurring. If at the end of the exposure period, the affected underlying is no longer in a Limit or Straddle State, the Market Order will be handled pursuant to the normal operation of the rules.

Lastly, ISE does not currently elect Stop Orders that are pending in the System during a Limit or Straddle State. Under the proposal, and in-line with the Phlx implementation, Stop Orders that are pending in the System during a Limit or Straddle State will be elected, if conditions for such election are met, and, because they become Market Orders, will be cancelled back to the Member with a reason for such rejection. The Exchange believes that this is consistent with the Act because it affords the appropriate protections to an elected Stop Order once it becomes a Market Order after election. The Exchange believes that this approach provides the market participant with the intended result.

#### **Auction Handling During a Trading Halt**

The Exchange's proposal to amend various rules to add detail to ISE rules to account for the impact of a trading halt on the Exchange's auction mechanisms is consistent with the Act for the reasons which follow. The Exchange's proposal to amend today's current behavior and instead terminate the auction and not execute eligible interest when a trading halt occurs is consistent with the Act because during a trading

halt, the market may move and create risk to market participants with respect to resting interest. The Exchange believes that terminating the PIM auction protects investors and the public interest by providing certainty to participants in regard to how their interest will be handled. Introducing consistent order handling and memorializing the manner in which the system will handle orders entered into PIM during a trading halt will provide transparency for the benefit of members and investors.

The Exchange's proposal to amend ISE Rule 716, entitled "Block Trades" to memorialize that if a trading halt is initiated after an order is entered into the Block Order Mechanism, Facilitation Mechanism, or Solicited Order Mechanism, such auction will also be automatically terminated without execution is consistent with the Act because in the event of a trading halt, terminating these auction mechanisms and not executing eligible interest will provide certainty to participants in regard to how their interest will be handled. Memorializing the manner in which the system will handle orders during a trading halt will provide transparency for the benefit of members and investors.

#### **Market Order Spread Protection**

The Exchange's proposal to amend ISE Rule 711 to adopt a mandatory risk protection entitled Market Order Spread Protection for single leg orders is consistent with the Act because it provides a protection for Market Orders that may encourage price continuity, which should, in turn, protect investors and the public interest by reducing executions occurring at dislocated prices. Further, the Exchange believes that this rule proposal will mitigate risks to market participants.

#### **Acceptable Trade Range**

The Exchange's proposal to amend ISE Rule 714 to remove the current Price Level Protection rule and adopt Phlx's Acceptable Trade Range for single leg orders is

consistent with the Act and will 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 by making the Exchange's market more efficient, to the benefit of the investing public. Further, it should prevent the system from experiencing dramatic price swings by creating a level of protection that prevents the market from moving beyond set thresholds. The proposed rule change will reduce the negative impacts of sudden, unanticipated volatility in individual options, and serve to preserve an orderly market in a transparent and uniform manner, enhance the price-discovery process, increase overall market confidence, and promote fair and orderly markets and the protection of investors. Specifically, the Exchange believes that the NBBO is a fair representation of then-available prices and accordingly the proposal helps to avoid executions at prices that are significantly worse than the NBBO.

With respect to the posting information, which is described in the Phlx rule, but not contained in the proposed ISE rule, the Exchange believes that it is consistent with the Act to cancel unexecuted interest which is priced through an Acceptable Trade Range. Today, the Exchange does not have an iterative process wherein the Exchange will attempt to execute unexecuted balances for a period of time while that interest is automatically re-priced on the order book. Phlx has this type of functionality for Acceptable Trade Range, while the Exchange does not re-price interest on the order book. The Exchange transparently describes the cancellation of the interest within its rules.

The Exchange's proposal to amend the current Price Level Protection Rule in Rule 714(b)(1) to relocate the provision to Rule 714(b)(4) and remove references to

PMM Order Handling is consistent with the Act because the Exchange will continue to offer this protection for complex orders. Unlike single leg orders which are subject to trade-through protections, complex orders do not have similar restrictions and therefore the Exchange believes that the current Price Level Protection Rule provides a better protection for complex orders because the Acceptable Trade Range protection described within this filing utilizes the NBBO and the Price Level Protection does not rely on the NBBO but rather limits the number of price levels.

#### **PMM Order Handling and Opening Obligations**

The Exchange's proposal to eliminate the PMMs order handling and opening obligations is consistent with the Act because PMMs will no longer have these obligations due to the introduction of Acceptable Trade Range and opening rotation functionality that is offered today on NOM and Phlx. Because the PMM will no longer have these obligations, the Exchange believes that it is appropriate to remove these rules.

#### **Back-Up PMM**

The Exchange's proposal to remove certain responsibilities of Primary Market Makers with respect to Back-Up Primary Market Maker assignments is consistent with the Act because the Exchange believes this function is not necessary. Today, in addition to market making obligations, the Primary Market Maker has certain order handling and other obligations as prescribed by Exchange Rules. Specifically, the obligations of a Primary Market Maker include the initiation of a trading rotation pursuant to ISE Rule 701, quoting and other obligations pursuant to ISE Rules 803 and 804, and financial requirements pursuant to ISE Rule 809. The Exchange is proposing to amend the obligations of a PMM only with regard to the initiation of a trading rotation pursuant to ISE Rule 701. The quoting and financial requirements rules shall remain the same. With

the re-platform, a Back-Up Primary Market Maker is no longer necessary since the order handling obligations present on ISE today are not going to be present in the new system. Furthermore, the proposed Opening Process,<sup>40</sup> obviates the importance of such a role. The Opening Process further describes alternative methods to open the market if such quotes are not entered at the opening by either of these market makers.<sup>41</sup> The reliance on a market maker to initiate the opening process is no longer present within the proposed rule.<sup>42</sup>

In addition, the Exchange does not believe there is an interest among market participants for the back-up assignment.

#### **Default Settings for Market Maker Risk Protections**

The Exchange's proposal to amend ISE Rule 804(g) to introduce default curtailment settings for the Market Maker Speed Bump and Market-Wide Speed Bump is consistent with the Act as it will allow market makers to use Exchange set default values for these risk protections. Today, these market makers would have their quotes rejected if they fail to enter the required curtailment parameters. The default settings provide an alternative for market makers that have not entered their curtailment settings. Default settings will be announced to members who will have the opportunity to avoid the defaults by entering their own curtailment settings as required under the rule.

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<sup>40</sup> See note 3 above.

<sup>41</sup> Id.

<sup>42</sup> Id.

**Anti-Internalization**

The Exchange's proposal to amend the ISE Supplementary Material at .03 to Rule 804 to add Anti-Internalization is consistent with the Act because it is designed to assist market makers in reducing trading costs from unwanted executions potentially resulting from the interaction of executable buy and sell trading interest from the same firm when performing the same market making function. Further, it is consistent with the Act to not apply this functionality in any auction or with respect to complex transactions because AIQ is difficult to apply during auctions, and there is limited benefit in doing so. There is limited benefit because, generally speaking, auctions do not raise the same policy concerns for wash sales and ERISA<sup>43</sup> due to the semi-random manner in which trades are matched. AIQ is unnecessary with respect to complex orders due to the highly specialized nature of such orders and the high level of control that market participants exercise over complex orders.

**Minimum Quantity Orders**

The Exchange believes that removing minimum quantity orders would remove impediments to and perfect the mechanism of a free and open market and a national market system by simplifying functionality available on the Exchange and reducing complexity of its order types.

**Delay of Implementation**

The Exchange believes that delaying the implementation of the Directed Order functionality on ISE is consistent with the Act because the Exchange desires to rollout this functionality at a later date to allow additional time to rebuild this technology on the

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<sup>43</sup> See note 34 above.

new platform. The Exchange is staging the replatform to provide maximum benefit to its Members while also ensuring a successful rollout. This delay will provide the Exchange additional time to implement this functionality, which is not being amended. Members will be given adequate notice of the implementation dates. The Exchange will continue to provide notifications to Members to ensure clarity about the delay of implementation of this functionality. The Exchange will note the applicable dates within the rule text.

4. 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. As explained above, the Exchange is re-platforming its trading system onto the Nasdaq INET architecture, and is making certain other changes to its trading functionality in connection with this migration. A majority of the functionality that is being added with the proposed rule change already exists on one or more Nasdaq Exchanges. As a result, the Exchange does not believe that the proposed rule change will impact the intense competition that exists in the options market. In fact, the Exchange believes that adopting this functionality on ISE will allow the Exchange to more effectively compete for order flow with other options markets.

5. 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.

6. Extension of Time Period for Commission Action

The Exchange does not consent to an extension of the time period for Commission action.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

The proposed rule change is based on the rules of the Nasdaq Exchanges with limited changes to account for differences in functionality offered on ISE. The relevant rule sections of the Nasdaq Exchanges, and differences between the ISE and NOM/Phlx functionality are described in the purpose and basis sections of this filing.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

1. Notice of proposed rule for publication in the Federal Register.
5. Text of the proposed rule change.



**EXHIBIT 1**

SECURITIES AND EXCHANGE COMMISSION  
(Release No. \_\_\_\_\_ ; File No. SR-ISE-2017-03)

February \_\_, 2017

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing of Proposed Rule Change to Amend Various Rules in Connection With a System Migration to Nasdaq INET technology

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 February 8, 2017, the International Securities Exchange, LLC (“ISE” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to amend various rules in connection with a system migration to Nasdaq INET technology.

The text of the proposed rule change is available on the Exchange’s Website at [www.ise.com](http://www.ise.com), at the principal office of the Exchange, and at the Commission’s Public Reference Room.

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

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

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.

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

1. Purpose

The purpose of this rule change is to amend certain rules to reflect the ISE technology migration to a Nasdaq, Inc. ("Nasdaq") supported architecture. INET is the proprietary core technology utilized across Nasdaq's global markets and utilized on The NASDAQ Options Market LLC ("NOM"), NASDAQ PHLX LLC ("Phlx") and NASDAQ BX, Inc. ("BX") (collectively, "Nasdaq Exchanges"). The migration of ISE to the Nasdaq INET architecture would result in higher performance, scalability, and more robust architecture. With this system migration, the Exchange intends to adopt certain trading functionality currently utilized at Nasdaq Exchanges. The functionality being adopted is described in this filing.

The Exchange is also separately filing<sup>3</sup> a rule change to amend the Exchange's Opening Process. ISE will replace its current opening process at Rule 701 with Phlx's Opening Process.<sup>4</sup>

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<sup>3</sup> See SR-ISE-2017-02 (not yet published).

<sup>4</sup> See Phlx Rule 1017. See also Securities Exchange Act Release No. 79274 (November 9, 2016), 81 FR 80694 (November 16, 2016) (SR-Phlx-2017-79)

The Exchange intends to begin implementation of the proposed rule changes in Q2 2017. The migration will be on a symbol by symbol basis, and the Exchange will issue an alert to members in the form of an Options Trader Alert to provide notification of the symbols that will migrate and the relevant dates.

### **Generally**

With the re-platform, the Exchange will now be built on the Nasdaq INET architecture, which allows certain trading system functionality to be performed in parallel. The Exchange believes that this architecture change will improve the member experience by reducing overall latency compared to the current ISE system because of the manner in which the system is segregated into component parts to handle processing.

### **Trading Halts**

#### **Cancellation of Quotes**

The Exchange proposes to amend ISE Rule 702 entitled “Trading Halts.” Specifically, the Exchange proposes to amend Rule 702(a)(2) to note that during a halt, the Exchange will maintain existing orders on the book, but not existing quotes prior to the halt, accept orders and quotes, and process cancels and modifications for quotes and orders, except that existing quotes are cancelled. Today, ISE maintains existing orders and quotes during a trading halt. With respect to cancels and modifications, this behavior will not change. ISE does not have a quote purge today, so this functionality will be changed with the adoption of this trading rule. The Exchange believes that purging quotes upon a halt will remove uncertainty for market participants.

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(notice of Filing of Partial Amendment No. 2 and Order Granting Approval of a Proposed Rule Change, as Modified by Partial Amendment No. 2, to Amend PHLX Rule 1017, Openings in Options).

The Exchange proposes to conform the treatment of quotes and orders on ISE to Phlx Rule 1047(f) in conjunction with the replatform of ISE. The Exchange desires to handle halts in a similar manner as Phlx.

### **Limit Up-Limit Down**

The Exchange also proposes to add new ISE Rule 702(d) to replace rule text currently contained in ISE Rule 703A entitled “Trading During Limit Up-Limit Down States in Underlying Securities.” Proposed ISE Rule 702(d) is similar to language currently in Phlx Rule 1047, entitled “Trading During Limit Up-Limit Down States in Underlying Securities.” Proposed ISE Rule 702(d) is similar to language currently in Phlx Rule 1047(d), which provides for Exchange handling due to extraordinary market volatility. Currently ISE Rule 703A(a) and (b) provides modified order handling procedures when a security underlying an options class traded on the Exchange enters a Limit State or Straddle State under the Plan to Address Extraordinary Market Volatility (the “Plan”).<sup>5</sup> Specifically, during a Limit State or Straddle State: (1) incoming Market

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<sup>5</sup> Unless otherwise specified, capitalized terms used in this rule filing are based on the defined terms of the Plan. As set forth in more detail in the Plan, Price Bands consisting of a Lower Price Band and an Upper Price Band for each NMS Stock are calculated by the Processors (Section V(A) of the Plan). When the National Best Bid (Offer) is below (above) the Lower (Upper) Price Band, the Processors shall disseminate such National Best Bid (Offer) with an appropriate flag identifying it as unexecutable. When the National Best Bid (Offer) is equal to the Upper (Lower) Price Band, the Processors shall distribute such National Best Bid (Offer) with an appropriate flag identifying it as a Limit State Quotation (Section VI(A) of the Plan). All trading centers in NMS stocks must maintain written policies and procedures that are reasonably designed to prevent the display of offers below the Lower Price Band and bids above the Upper Price Band for NMS stocks. Notwithstanding this requirement, the Processor shall display an offer below the Lower Price Band or a bid above the Upper Price Band, but with a flag that it is non-executable. Such bids or offers shall not be included in the National Best Bid or National Best Offer calculations (Section VI(A)(3) of the Plan). Trading in an NMS stock immediately enters a Limit State if the National Best Offer (Bid) equals but does not cross the Lower (Upper) Price Band (Section

Orders are automatically rejected, and all unexecuted Market Orders pending in the System are cancelled, and (2) incoming Stop Orders (which become Market Orders if elected) are automatically rejected, and unexecuted Stop Orders pending in the System cannot be elected and will be held until the end of the Limit State or Straddle State. In addition, ISE Rule 703A(c) provides that when the security underlying an option class is in a Limit State or Straddle State, the maximum quotation spread requirements for market maker quotes contained in ISE Rule 803(b)(5) and the continuous quotation requirements contained in ISE Rule 804(e) shall be suspended.<sup>6</sup>

With the re-platform, the Exchange will adopt opening limitation, Market Order and Stop Order handling consistent with handling today on Phlx.<sup>7</sup> Specifically, proposed

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VI(B)(1) of the Plan. Trading for an NMS stock exits a Limit State if, within 15 seconds of entering the Limit State, all Limit State Quotations were executed or canceled in their entirety. If the market does not exit a Limit State within 15 seconds, then the Primary Listing Exchange would declare a five-minute trading pause pursuant to Section VII of the Plan, which would be applicable to all markets trading the security. The primary listing market would declare a Trading Pause in an NMS stock; upon notification by the primary listing market, the Processor would disseminate this information to the public. No trades in that NMS stock could occur during the trading pause, but all bids and offers may be displayed (Section VII(A) of the Plan). In addition, the Plan defines a Straddle State as when the National Best Bid (Offer) is below (above) the Lower (Upper) Price Band and the NMS stock is not in a Limit State. For example, assume the Lower Price Band for an NMS Stock is \$ 9.50 and the Upper Price Band is \$ 10.50, such NMS stock would be in a Straddle State if the National Best Bid were below \$ 9.50, and therefore unexecutable, and the National Best Offer were above \$ 9.50 (including a National Best Offer that could be above \$ 10.50). If an NMS stock is in a Straddle State and trading in that stock deviates from normal trading characteristics, the Primary Listing Exchange may declare a trading pause for that NMS stock if such Trading Pause would support the Plan's goal to address extraordinary market volatility.

<sup>6</sup> The time periods associated with Limit States and Straddle States are not considered by the Exchange when evaluating whether a market maker complied with the continuous quotation requirements contained in Rule 804(e).

<sup>7</sup> See proposed ISE Rule 702(d)(ii) and (iii).

ISE Rule 702(d) will provide that during a Limit State and Straddle State in the Underlying NMS stock: (i) the Exchange will not open an affected option, (ii) provided the Exchange has opened an affected option for trading, the Exchange shall reject Market Orders,<sup>8</sup> as defined in ISE Rule 715(a), and shall notify Members of the reason for such rejection, and (iii) provided the Exchange has opened an affected option for trading, the Exchange will elect Stop Orders if the condition is met, and, because they become Market Orders, shall cancel them back and notify Members of the reason for such rejection. The language in proposed ISE Rule 703(d)(iv) concerning the maximum quotation spread requirements for market maker quotes and the continuous quotation requirements suspensions are the same language currently contained in ISE Rule 703A(c).

These amendments differ in certain respects from the manner in which ISE operates today during a Limit State or Straddle State. The current ISE rule does not address the opening. The Exchange proposes to adopt rule text to provide for how the Exchange shall treat the opening rotation.<sup>9</sup> The opening in an option will not commence in the event that the underlying NMS stock is open, but has entered into a Limit State or Straddle State. If this occurs, the opening will only commence and complete if the underlying NMS stock stays out of a Limit or Straddle State. Accordingly, proposed ISE Rule 702(d)(i) will provide that the Exchange will not open an affected option. As a

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<sup>8</sup> This includes complex orders as well as single leg orders. The Exchange shall cancel complex orders that are Market Orders residing in the System if they are about to be executed by the System.

<sup>9</sup> See note 3 above.

result, if an opening process is occurring, it will cease and then start the opening process from the beginning once the Limit State or Straddle State is no longer occurring.

In addition, ISE currently cancels Market Orders pending in the System upon initiation of a Limit or Straddle State. Under the proposal to adopt the Phlx rule and implementation of the Limit Up-Limit Down procedures, Market Orders pending in the System will continue to be processed regardless of the Limit or Straddle State. The Exchange believes this is a reasonable handling of Market Orders in the system since these orders are only pending in the System if they are exposed at the NBBO pursuant to Supplementary Material .02 to ISE Rule 1901 or a complex order exposed for price improvement pursuant to ISE Rule 722(b)(3)(iii). In both cases, if at the end of the exposure period the affected underlying is in a Limit or Straddle State, the Market Order will be cancelled with no execution occurring. If at the end of the exposure period the underlying is no longer in a Limit or Straddle State, the Market Order will be handled under the normal operation of the rules.

Lastly, ISE does not currently elect Stop Orders that are pending in the System during a Limit or Straddle State. Under the proposal, and in-line with the Phlx implementation, Stop Orders that are pending in the System during a Limit or Straddle State will be elected, if conditions for such election are met, however because they become Market Orders will be cancelled back to the Member with a reason for such rejection.

While the implementation of Market and Stop Order handling varies from ISE today, both the current and proposed Rule provide for protections from erroneous

executions in a highly volatile period.<sup>10</sup> The Exchange believes consistency across the six options markets operated by Nasdaq, Inc. provides clarity for Members as to how their orders, as well as the opening process, will be handled in a Limit or Straddle State.

### **Auction Handling During a Trading Halt**

The Exchange proposes to amend various rules to add detail to ISE rules to account for the impact of a trading halt on the Exchange's auction mechanisms. The Exchange proposes to memorialize within ISE Rule 723, entitled "Price Improvement Mechanism for Crossing Transactions" the manner in which a trading halt will impact an order entered into PIM once it is migrated to the INET architecture.

Today, if a trading halt is initiated after a single leg order is entered into the Price Improvement Mechanism ("PIM") on ISE, such auction is terminated and eligible interest is executed or in the case of a complex order entered into PIM, the auction is terminated and eligible interest is cancelled without execution. The Exchange is amending the behavior with respect to single leg orders in PIM auctions to terminate the auction and not execute eligible interest when a trading halt occurs. In the event of a trading halt, terminating the auction and not executing eligible interest will provide certainty to participants in regard to how their interest will be handled. Introducing consistent order handling, regardless of single leg or complex, and memorializing the manner in which the system will handle all orders entered into PIM during a trading halt will provide transparency for the benefit of members and investors. The Exchange is not amending the behavior with respect to complex orders in PIM auctions.

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<sup>10</sup> The Exchange is introducing a Phlx protection, Acceptable Trade Range, into ISE Rules as discussed within this rule change.



The Exchange proposes an amendment to ISE Rule 716, entitled “Block Trades” to memorialize that if a trading halt is initiated after an order is entered into the Block Order Mechanism, Facilitation Mechanism, or Solicited Order Mechanism, such auction will also be automatically terminated without execution. This is the current behavior today on ISE and will not be changing.

As discussed above, Phlx Rule 1047(c) provides that in the event the Exchange halts trading, all trading in the affected option shall be halted. This is interpreted to restrict executions after a halt unless there is a specific rule specifying that such trades should take place. The Exchange is proposing to add more specificity into the relevant rules. With respect to Block Order Mechanism, Facilitation Mechanism, or Solicited Order Mechanism, the Exchange notes that the current behavior is consistent with Phlx Rule 1047(c) generally, where all trading in the affected option shall be halted.<sup>11</sup> In the event of a trading halt, terminating these auction mechanisms and not executing eligible interest will provide certainty to participants in regard to how their interest will be handled. Memorializing the manner in which the system will handle orders during a trading halt will provide transparency for the benefit of members and investors.

#### **Market Order Spread Protection**

The Exchange proposes to amend ISE Rule 711, entitled “Acceptance of Quotes and Orders” to adopt a new mandatory risk protection entitled Market Order Spread Protection which will apply to single leg Market Orders. ISE does not have a similar

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<sup>11</sup> See Phlx Rule 1047(c).

feature today. This mandatory feature is currently offered on NOM to protect Market Orders from being executed in very wide markets.<sup>12</sup>

Pursuant to proposed ISE Rule 711(c), if the NBBO is wider than a preset threshold at the time a Market Order is received, the order will be rejected. For example, if the Market Order Spread Protection is set to \$20.00, and a Market Order to buy is received while the NBBO is \$1.00 - \$50.00, such Market Order will be rejected. The proposed feature would assist with the maintenance of fair and orderly markets by mitigating the risks associated with errors resulting in executions at prices that are away from the Best Bid or Offer and potentially erroneous. Further the proposal protects investors from potentially receiving executions away from the prevailing prices at any given time. The Exchange proposes this feature to avoid a series of improperly priced aggressive orders transacting in the Order Book.

Today, the NOM threshold is set at \$5. ISE will initially set the threshold to \$5. Similar to NOM, the Exchange will notify Members of the threshold with a notice, and, thereafter, Members will be notified of any subsequent changes to the threshold. NOM set the differential at \$5 to match the bid/ask differential permitted for quotes on the Exchange.<sup>13</sup> ISE has a similar \$5 differential.<sup>14</sup> Thus, the presence of a quote on the

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<sup>12</sup> See NOM Rules at Chapter VI, Section 6(c). NOM's current rule states, "System Orders that are Market Orders will be rejected if the *best of the* NBBO and the internal market BBO (the "Reference BBO") is wider than a preset threshold at the time the order is received by the System." NOM has two order types, Price-Improving and Post-Only Orders, which result in non-displayed pricing that may cause the internal market BBO to be better than the NBBO. ISE does not have similar non-displayed order types and therefore the reference to the internal market BBO is not necessary.

<sup>13</sup> See Chapter VII, Section 6(d)(ii) of NOM Rules which describes the bid/ask differentials. Options on equities (including Exchange-Traded Fund Shares), and on index options must be quoted with a difference not to exceed \$5 between the

Exchange will ensure the NBBO is at least \$5 wide. The Exchange believes the presence of a quote on the Exchange, or a bid/ask differential of the NBBO, which is no more than \$5 wide affords Market Orders proper protection against erroneous execution and in the event a bid/ask differential is more than \$5, then a Market Order is rejected. The threshold is appropriate because it seeks to capture improperly priced Market Orders and reject them to reduce the risk of, and to potentially prevent, the automatic execution of Market Orders at prices that may be considered erroneous. The Exchange's proposed threshold is a reasonable measure to ensure prices remain within the reasonable limits. This protection will bolster the normal resilience and market behavior that persistently produces robust reference prices. This feature should create a level of protection that prevents Market Orders from entering the Order Book outside of an acceptable range for the Market Order to execute.

Finally, the Market Order Spread Protection will be the same for all options traded on the Exchange, and is applicable to all Members that submit Market Orders.

### **Acceptable Trade Range**

The Exchange proposes to amend ISE Rule 714, entitled "Automatic Execution of Orders," at ISE Rule 714(b)(1) to adopt Phlx's Acceptable Trade Range for single leg

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bid and offer regardless of the price of the bid, including before and during the opening. However, respecting in-the-money series where the market for the underlying security is wider than \$5, the bid/ask differential may be as wide as the quotation for the underlying security on the primary market. The Exchange may establish differences other than the above for one or more series or classes of options.

<sup>14</sup> See ISE Rule 803(b)(4).

orders.<sup>15</sup> The Exchange is proposing to adopt similar functionality which is currently utilized on Phlx in connection with the replatform of ISE for single leg orders. Today, ISE places a limit on the number of price levels at which an incoming order or quote to sell (buy) will be executed automatically when there are no bids (offers) from other exchanges at any price for the options series. Orders and quotes are executed at each successive price level until the maximum number of price levels is reached, and any balance is either handled by the Primary Market Maker pursuant to Rule 803(c)(1) (in the case of Priority Customer Orders) or canceled (in the case of Professional Orders). The number of price levels, may be between one (1) and ten (10). The Exchange determines the number of price levels from time-to-time on a class-by-class basis.

ISE proposes to replace the current Price Level Protection applied to single leg orders with Phlx's Acceptable Trade Range.<sup>16</sup> The proposed Acceptable Trade Range is a mechanism to prevent the system from experiencing dramatic price swings by creating a level of protection that prevents the market from moving beyond set thresholds. The thresholds consist of a reference price plus (minus) set dollar amounts based on the nature of the option and the premium of the option.

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<sup>15</sup> See Phlx Rule 1080(p). Today, ISE places a limit on the number of price levels at which an incoming order or quote to sell (buy) will be executed automatically for single leg and complex orders when there are no bids (offers) from other exchanges at any price for the options series. Orders and quotes are executed at each successive price level until the maximum number of price levels is reached, and any balance is either handled by the Primary Market Maker pursuant to Rule 803(c)(1) (in the case of Priority Customer Orders) or canceled (in the case of Professional Orders). The number of price levels, may be between one (1) and ten (10). The Exchange determines the number of price levels from time-to-time on a class-by-class basis. This proposal only impacts single leg orders.

<sup>16</sup> The Exchange notes that the version of Acceptable Trade Range to be implemented on ISE will not include the posting period functionality available today on Phlx. The proposed rules reflect this change.

The system will calculate an Acceptable Trade Range to limit the range of prices at which an order or quote will be allowed to execute. To bolster the normal resilience and market behavior that persistently produces robust reference prices, ISE is proposing to create a level of protection that prevents the market from moving beyond set thresholds. The Acceptable Trade Range is calculated (upon receipt of a new order or quote) by taking the reference price, plus or minus a value to be determined by the Exchange (i.e., the reference price - (x) for sell orders/quotes and the reference price + (x) for buy orders).<sup>17</sup> Upon receipt of a new order, the reference price is the National Best Bid (“NBB”) for sell orders/quotes and the National Best Offer (“NBO”) for buy orders/quotes. If an order or quote reaches the outer limit of the Acceptable Trade Range (the “Threshold Price”) without being fully executed, then any unexecuted balance will be cancelled. The proposed Acceptable Trade Range would work as follows: prior to executing orders received by ISE, an Acceptable Trade Range is calculated to determine the range of prices at which orders/quotes may be executed.<sup>18</sup> When an order is initially received, the threshold is calculated by adding (for buy orders/quotes) or subtracting (for sell orders/quotes) a value,<sup>19</sup> as discussed below, to the National Best Offer for buy orders/quotes or the National Best Bid for sell orders/quotes to determine the range of prices that are valid for execution. A buy (sell) order or quote will be allowed to execute

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<sup>17</sup> The Acceptable Trade Range settings are tied to the option premium.

<sup>18</sup> The Acceptable Trade Range will not be available for all-or-none orders. Today, ISE’s Price Level Protection rule is not available for all-or-none orders. The Exchange has determined that it would be difficult, from a technical standpoint, to apply this feature to those orders because their particular contingency makes it difficult to automate their handling.

<sup>19</sup> The value that is to be added to/subtracted from the reference price will be set by ISE and posted on its website.

up (down) to and including the maximum (minimum) price within the Acceptable Trade Range.

For example, in a thinly traded option:

Away Exchange Quotes:

Exchange	Bid Size	Bid Price	Offer Price	Offer Size
NOM	10	\$1.00	\$1.05	10
NYSE Arca	10	\$1.00	\$1.05	10
NYSE MKT	10	\$1.00	\$1.10	10
BOX	10	\$1.00	\$1.15	10

ISE Price Levels:

Exchange	Bid Size	Bid Price	Offer Price	Offer Size
ISE orders	10	\$1.00	\$1.05	10
ISE orders			\$1.10	10
ISE orders			\$1.40	10
ISE orders			\$5.00	10

If ISE receives a routable market order to buy 80 contracts, the System will respond as described below:

- 10 contracts will be executed at \$1.05 against ISE
- 10 contracts will be executed at \$1.05 against NOM
- 10 contracts will be executed at \$1.05 against NYSE Arca.
- 10 contracts will be executed at \$1.10 against ISE
- 10 contracts will be executed at \$1.10 against NYSE MKT
- 10 contracts will be executed at \$1.15 against BOX

After these executions, there are no other known valid away exchange quotes. The National Best Bid/Offer (“NBBO”) is therefore comprised of the remaining interest on the ISE book, specifically 10 contracts at \$1.40 and 10 contracts at \$5.00. In the absence of an Acceptable Trade Range mechanism, the order would execute against the remaining interest at \$1.40 and \$5.00, resulting in potential harm to investors.

ISE will set the parameters of the mechanism at levels that will ensure that it is triggered quite infrequently. Importantly, the Acceptable Trade Range is neutral with respect to away markets, an order may route to other destinations to access liquidity priced within the Acceptable Trade Range provided the order is designated as routable.

The options premium will be the dominant factor in determining the Acceptable Trade Range. Generally, options with lower premiums tend to be more liquid and have tighter bid/ask spreads; options with higher premiums have wider spreads and less liquidity. Accordingly, a table consisting of several steps based on the premium of the option will be used to determine how far the market for a given option will be allowed to move. This table or tables would be listed on the NASDAQTrader.com website and any periodic updates to the table would be announced via an Options Trader Alert.

For example, looking at some SPY May 2013 Call options on May 1st of 2013:

Bid/Offer of SPY May 160 Call (at or near-the-money): \$1.23 x \$1.24 (several hundred contracts on bid and offer)

Bid/Offer of SPY May 105 Call (deep in-the-money): \$54.10 x \$54.26 (11 contracts on each side)

The deep in-the-money calls (May 105 calls) have a wider spread ( $\$54.10 - \$54.26 = \$0.16$ ) compared to a spread of \$0.01 for the at-the-money calls (May 160 calls).

Therefore, it is appropriate to have different thresholds for the two options. For instance,

it may make sense to have a \$0.05 threshold for the at-the-money strikes (Premium < \$2) and a \$0.50 threshold for the deep in-the-money strikes (Premium > \$10).

To consider another example, the May 2013 ORCL put options on May 1st of 2013:

Bid/Offer of ORCL 33 May Put (at or near-the-money): \$0.33 x \$0.34 (100x500)  
Bid/Offer of ORCL 44 May Put (deep in-the-money): \$10.40 x \$10.55 (50 x 200)  
Even though ORCL has a much lower share price than SPY, and is a different

type of security (it is a common stock of a technology company whereas SPY is an ETF based on the S&P 500 Index), the pattern is the same. The option with the lower premium has a very narrow spread of \$0.01 with significant size displayed whereas the higher premium option has a wide spread (\$0.15) and less size displayed.

The Acceptable Trade Range settings will be tied to the option premium. However, other factors will be considered when determining the exact settings. For example, acceptable ranges may change if market-wide volatility is as high as it was during the financial crisis in 2008 and 2009, or if overall liquidity is low based on historical trends. These different market conditions may present the need to adjust the threshold amounts from time to time to ensure a well-functioning market. Without adjustments, the market may become too constrained or conversely, prone to wide price swings. As stated above, the Exchange would publish the Acceptable Trade Range table or tables on the Exchange website. The Exchange does not foresee updating the table(s) often or intraday, although the exchange may determine to do so in extreme circumstances. The Exchange will provide sufficient advanced notice of changes to the Acceptable Trade Range table, generally the prior day, to its membership via an Exchange alert.



The Acceptable Trade Range settings would generally be the same across all options traded on ISE, although ISE proposes to maintain flexibility to set them separately based on characteristics of the underlying security. For instance, Google is a stock with a high share price (\$824.57 closing price on April 30, 2013). Google options therefore may require special settings due to the risk involved in actively quoting options on such a high-priced stock. Option spreads on Google are wider and the size available at the best bid and offer is smaller. Google could potentially need a wider threshold setting compared to other lower-priced stocks. There are other options that fit into this category (e.g., AAPL) which makes it necessary to have threshold settings that have flexibility based on the underlying security. Additionally, it is generally observed that options subject to the Penny Pilot program quote with tighter spreads than options not subject to the Penny Pilot. Currently, ISE expects to set Acceptable Trade Ranges for three categories of options: (1) Penny Pilot Options trading in one cent increments for options trading at less than \$3.00 and increments of five cents for options trading at \$3.00 or more, (2) Penny Pilot Options trading in one-cent increments for all prices, and (3) Non-Penny Pilot Options.

The Phlx rule contains language that references a posting period.<sup>20</sup> Specifically, the Phlx Rule provides if an order/quote reaches the outer limit of the Acceptable Trade Range (the “Threshold Price”) without being fully executed, it will be posted at the Threshold Price for a brief period, not to exceed one second (“Posting Period”), to allow more liquidity to be collected, unless a Quote Exhaust has occurred, in which case the Quote Exhaust process in Phlx Rule 1082(a)(ii)(B)(3) will ensue, triggering a new

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<sup>20</sup> See Phlx Rule 1080(p)(1)(B).

Reference Price.<sup>21</sup> The Exchange will not post interest that exceeds the outer limit of the Acceptable Trade Range, rather the interest will be cancelled. Only if the order limit does not exceed the Acceptable Trade Range will it post on the Exchange, if not otherwise executed. Further, the Phlx rule provides for the re-pricing of that order or quote and calculation of a new Acceptable Trade Range. Consistent with the current treatment of orders and quotes under ISE rules, the Exchange is not adopting the posting period. Unlike Phlx, ISE does not offer a general continuous re-pricing mechanism, and does not consider iterations in its current functionality.<sup>22</sup> ISE would cancel rather than reprice orders which exceed the outer limit of the Acceptable Trade Range. Orders which do not exceed the outer limit of the Acceptable Trade Range will post to the order book and will reside on the order book at such price until they are either executed in full or cancelled by the Member. Additionally, resting orders do not re-price on the order book as they do today on Phlx. For these reasons, the unexecuted balance which exceeds

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<sup>21</sup> The Quote Exhaust process occurs when the Exchange's disseminated market at a particular price level includes a quote, and such market is exhausted by an inbound contra-side quote or order, and following such exhaustion, contracts remain to be executed from such quote or order through the initial execution price.

<sup>22</sup> With respect to trade-throughs and locked and crossed markets, a Phlx order will not be executed at a price that trades through another market or is displayed at a price that would lock or cross another market. If, at the time of entry, an order that the entering party has elected not to make eligible for routing would cause a locked or crossed market violation or would cause a trade-through violation, it will be re-priced to the current national best offer (for bids) or the current national best bid (for offers) and displayed at one minimum price variance above (for offers) or below (for bids) the national best price. See Phlx Rule 1080(m)(iv)(A). In the instance that the System automatically reprices an order or quote, the System would assign the orders or quote a new timestamp and the order or quote will be reprioritized within the Order Book in accordance with the priority rules in Phlx Rule 1014 (g).

the outer limit of the Acceptable Trade Range will be cancelled, rather than posted to the order book.

For complex orders, the Exchange will continue to apply the Price Level Protection Rule which is being relocated to Rule 714(b)(4) and revised to specifically state that the Price Level Protection shall apply to complex orders. The functionality will remain the same. The Exchange is amending the current rule to remove references that specifically related to single leg order functionality. Primary Market Maker handling does not apply to complex orders and therefore is being removed from the rule text. The Exchange is also adding references to component legs to make clear the application to complex orders. Unlike single leg orders which are subject to trade-through protections, complex orders do not have similar restrictions and therefore the Exchange believes that the current Price Level Protection Rule provides a better protection for complex orders because the Acceptable Trade Range protection described within this filing utilizes the NBBO and the Price Level Protection does not rely on the NBBO but rather limits the number of price levels.

#### **PMM Order Handling and Opening Obligations**

Today, PMMs are responsible for handling Priority Customer orders that are not automatically executed pursuant to ISE Rule 714(b)(1), i.e., the Price Level Protection, and to initiate the opening rotation in each series pursuant to ISE Rule 701. This responsibility is described in each of those rules, as well as in ISE Rule 803(c), which provides that:

In addition to the obligations contained in this Rule for market makers generally, for options classes to which a market maker is the appointed Primary Market Maker, it shall have the responsibility to: (1) As soon as practical, address Priority Customer Orders that are not automatically executed pursuant to Rule 714(b)(1) in a manner consistent with its obligations under paragraph (b) of this Rule by

either (i) executing all or a portion of the order at a price that at least matches the NBBO and that improves upon the Exchange's best bid (in the case of a sell order) or the Exchange's best offer (in the case of a buy order); or (ii) releasing all or a portion of the order for execution against bids and offers on the Exchange. (2) Initiate trading in each series pursuant to Rule 701.

As described in more detail in the sections above, with the re-platform to Nasdaq technology, the Exchange is adopting Acceptable Trade Range and opening rotation functionality currently offered on NOM and Phlx, which do not contain similar requirements for the PMM. The Exchange therefore proposes to eliminate the PMM order handling and opening obligations in Rule 803(c).

The Exchange believes that the elimination of the PMM obligation to initiate the opening rotation in this rule is appropriate because the proposed opening process<sup>23</sup> is initiated by the receipt of an appropriate number of valid width Primary Market Maker or Competitive Market Maker quotes as outlined in proposed ISE Rule 701(c)(i). Similarly, the Acceptable Trade Range functionality will continue to provide an important protection to members without imposing any Primary Market Maker obligations. Today, Phlx does not have similar roles for a Specialist on its market. In connection with the replatform, the Exchange will conform its rules with those of Phlx with respect to the manner in which it operates the Opening Process.

### **Back-Up PMM**

The Exchange also proposes to amend ISE Supplementary Material .03 to Rule 803 to eliminate its Back-Up Primary Market Maker program. Today, any ISE Member that is approved to act in the capacity of a Primary Market Maker may voluntarily act as a "Back-Up Primary Market Maker" in options series in which it is quoting as a

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<sup>23</sup> See note 3 above.

Competitive Market Maker. A Back-Up Primary Market Maker assumes all of the responsibilities and privileges of a Primary Market Maker under the Exchange's rules with respect to any series in which the appointed Primary Market Maker fails to have a quote in the System except that a Back-Up Primary Market Maker's quoting obligations are the same as the quoting obligations for Competitive Market Makers as described in ISE Rule 804(e)(2)(iii) and .02 of Supplementary Material to Rule 804.<sup>24</sup> If more than one Competitive Market Maker that has volunteered to be a Back-Up Primary Market Maker is quoting in an options series at the time that a Primary Market Maker ceases quoting, the Competitive Market Maker with the largest offer at the lowest price in the series at that time will be chosen to be the Back-Up Primary Market Maker. In the event of a tie based on price and size, the Competitive Market Maker with time priority will be automatically chosen. The Back-Up Primary Market Maker is automatically restored to Competitive Market Maker status when the appointed Primary Market Maker initiates quoting in the series. The obligations of a Primary Market Maker include the initiation of a trading rotation pursuant to ISE Rule 701, quoting and other obligations pursuant to ISE Rules 803 and 804, and financial requirements pursuant to ISE Rule 809. The Exchange is proposing to amend the obligations of a PMM only with regard to the initiation of a trading rotation pursuant to ISE Rule 701. The quoting and financial requirements rules shall remain the same.

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<sup>24</sup> The Exchange notes that the current rule text for Back-up Primary Market Maker on ISE does not indicate that quoting obligations for Back-up Primary Market Makers are the same as for Competitive Market Makers. This, however, has been the Exchange's practice. See Securities Exchange Act Release No. 76936 (January 20, 2016), 81 FR 4347 (January 26, 2016) (SR-ISE-2016-02).

With the re-platform, a Back-Up Primary Market Maker is no longer necessary since the order handling obligations present on ISE today are not going to be present in the new system. Furthermore, the proposed Opening Process obviates the importance of such a role. The Opening Process describes the entry of quotes by both a Primary Market Maker and a Competitive Market Maker, provided they are Valid Width Quotes.<sup>25</sup> The Opening Process further describes alternative methods to open the market if such quotes are not entered at the opening by either of these market makers.<sup>26</sup> The reliance on a market maker to initiate the opening process is no longer present within the proposed rule.<sup>27</sup>

### **Market Maker Speed Bump**

The Exchange proposes to amend ISE Rule 804, entitled “Market Maker Quotations” to establish default parameters for certain risk functionality. The Exchange offers a risk protection mechanism for market maker quotes that removes a member’s quotes in an options class if a specified number of curtailment events occur during a set time period (“Market Maker Speed Bump”). In addition, the Exchange offers a market-wide risk protection that removes a market maker’s quotes across all classes if a number of curtailment events occur (“Market-Wide Speed Bump”).<sup>28</sup> ISE Rule 804(g) currently requires that market makers set curtailment parameters for both the Market Maker Speed

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<sup>25</sup> A Valid Width Quote is a two-sided electronic quotation submitted by a Market Maker that consists of a bid/ask differential that is compliant with ISE proposed Rule 803(b)(4). See note 3 above.

<sup>26</sup> See note 3 above.

<sup>27</sup> Id.

<sup>28</sup> Market makers may request the Exchange to set the market wide parameter to apply to just ISE or across ISE and ISE Gemini.

Bump and the Market-Wide Speed Bump. Today, if a market maker does not set these parameters their quotes are rejected by the trading system for each of the speed bumps mentioned herein.

With the re-platform, the Exchange has determined to provide default curtailment parameters to assist market makers when they do not enter their own parameters into the system. The default parameters will be determined by the Exchange and announced to members. Rather than rejecting quotes, the default parameters would be instituted. The default parameters are important because market makers at ISE have quoting obligations as specified in ISE Rule 804. When a market maker's quotes are removed from the system, the time does not count toward the continuous quoting obligations. The Exchange believes that allowing for default settings would cause quotes not to be rejected and would assist market makers in meeting their quoting obligations because they would not have their quotes removed from the market. Today, Phlx indicates default parameters for its detection of loss of communication settings.<sup>29</sup>

### **Anti-Internalization**

The Exchange proposes to amend the ISE Supplementary Material at .03 to Rule 804, entitled "Market Maker Quotations" to adopt Anti-Internalization rule. Today, ISE's functionality prevents Immediate-or-Cancel ("IOC")<sup>30</sup> orders entered by a market maker from trading with the market maker's own quote.<sup>31</sup> As implemented, if an IOC

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<sup>29</sup> Phlx Rule 1019(c).

<sup>30</sup> An IOC order is a limit order that is to be executed in whole or in part upon receipt. Any portion not so executed is to be treated as cancelled. See Rule 715(b)(3).

<sup>31</sup> This functionality is not memorialized in ISE's rules.

order entered by a market maker would trade with a quote entered by the same market maker, that order will instead be allocated to other interest at the same price, and the balance cancelled. The Exchange proposes to replace this self-trade protection functionality with Anti-Internalization functionality currently offered on Phlx.<sup>32</sup>

Today, Phlx provides anti-internalization (“AIQ”) functionality to Specialists and Registered Options Traders (“collectively market makers”). Quotes and orders entered by Phlx market makers using the same badge<sup>33</sup> are not executed against quotes and orders entered on the opposite side of the market using the same badge. This automatically prevents these quotes and orders from interacting with each other in the System. On Phlx, the system cancels the resting quote or order back to the entering party prior to execution. This functionality does not apply in any auction or with respect to complex transactions.

The Exchange proposes to adopt a similar rule that provides that quotes and orders entered by Market Makers using the same member identifier will not be executed against quotes and orders entered on the opposite side of the market by the same market maker using the same member identifier. In such a case, the system will cancel the resting quote or order back to the entering party prior to execution. This functionality shall not apply in any auction or with respect to complex transactions. AIQ is difficult to apply during auctions, and there is limited benefit in doing so. There is limited benefit because, generally speaking, auctions do not raise the same policy concerns for wash

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<sup>32</sup> See Phlx Rule 1080(p)(2).

<sup>33</sup> A badge is the same as a market participant identifier (“MPID”).



sales and ERISA<sup>34</sup> due to the semi-random manner in which trades are matched. AIQ is unnecessary with respect to complex orders due to the highly specialized nature of such orders and the high level of control that market participants exercise over complex orders.

This functionality does not relieve or otherwise modify the duty of best execution owed to orders received from public customers. Market Makers generally do not display public customer orders in market making quotations, opting instead to enter public customer orders using separate identifiers. In the event that a Market Maker opts to include a public customer order within a market making quotation, the Market Maker must take appropriate steps to ensure that public customer orders that do not execute due to anti-internalization functionality ultimately receive the same execution price (or better) they would have originally obtained if execution of the order was not inhibited by the functionality.

This Anti-Internalization functionality can assist Market Makers in reducing trading costs from unwanted executions potentially resulting from the interaction of executable buy and sell trading interest from the same firm when performing the same market making function.

### **Minimum Execution Quantity Orders**

The Exchange proposes to amend ISE Rule 715, entitled “Types of Orders” at 715(q) to remove minimum quantity orders. Today, the Exchange allows members to

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<sup>34</sup> AIQ also is designed to assist market participants in complying with certain rules and regulations of the Employee Retirement Income Security Act (“ERISA”) that preclude and/or limit managing broker-dealers of such accounts from trading as principal with orders generated for those accounts. It can also assist Market Makers in reducing trading costs from unwanted executions potentially resulting from the interaction of executable buy and sell trading interest from the same firm when performing the same market making function.

enter minimum quantity orders, which is an order type that is available for partial execution, but each partial execution must be for a specified number of contracts or greater. If the balance of the order after one or more partial executions is less than the minimum, such balance is treated as all-or-none. Like all-or-none orders, minimum quantity orders are contingency orders that are not displayed in the Exchange's best bid or offer. However, the Exchange disseminates to market participants an indication that a minimum quantity order has been entered. The Exchange has found that the utilization of minimum quantity orders by its members has been very limited, and therefore proposes to remove this functionality.<sup>35</sup> Furthermore, the Exchange proposes to remove two references to minimum quantity orders in other rules. Specifically, the Exchange proposes to remove references to minimum quantity orders in ISE Supplementary Material .02 to Rule 713, which notes that minimum quantity orders are contingency orders that have no priority on the book, and in ISE Supplementary Material .04 to Rule 717, which explains that non-marketable minimum quantity orders are deemed "exposed" one second following a broadcast notifying the market that such an order to buy or sell a specified number of contracts at a specified with a specified minimum quantity has been received in the options series.

### **Delay of Implementation**

The Exchange proposes to delay the implementation of Directed Order<sup>36</sup> functionality on ISE. The Exchange proposes to continue to offer this functionality on

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<sup>35</sup> This functionality is currently being utilized to transact less than 1% of ISE's volume.

<sup>36</sup> ISE currently operates a Directed Order system in which Electronic Access Members ("EAMs") can send an order to a DMM for possible price improvement. If a DMM accepts Directed Orders generally, that DMM must accept all Directed

the current platform. The Exchange however would propose not to launch the Directed Order functionality on ISE at the same time as proposed herein for the proposals to amend other trading functions. The Exchange would instead issue an alert which specifies a different date for this functionality to commence on ISE. This functionality will remain the same on the new platform.

The Exchange proposes to amend the rule text in Rule 811 (Directed Orders) to note that this functionality will not be available as of a certain date in the second quarter of 2017 to be announced in a notice. The Exchange will recommence this functionality on ISE within one year from the date of filing of this rule change to be announced in a separate notice.

The Exchange intends to begin implementation of the functionality for Directed Orders after Q2 2017. The migration will also be on a symbol by symbol basis, and the Exchange will issue an alert to members in the form of an Options Trader Alert to provide notification of the symbols that will migrate and the relevant dates. The Exchange will introduce Directed Orders on ISE within one year from the date of this filing, otherwise the Exchange will file a rule proposal with the Commission to remove these rules.

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Orders from all EAMs. Once such a DMM receives a Directed Order, it either (i) must enter the order into the Exchange's PIM auction and guarantee its execution at a price better than the ISE best bid or offer ("ISE BBO") by at least a penny and equal to or better than the NBBO or (ii) must release the order into the Exchange's limit order book, in which case there are certain restrictions on the DMM interacting with the order. See ISE Rule 811.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>37</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>38</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 for the reasons stated below.

### **Trading Halts**

The Exchange's proposal to amend ISE Rule 702 concerning Trading Halts to specifically note that during a halt the Exchange will maintain existing orders on the book but not existing quotes is consistent with the Act because it provides market participants with clarity as to the manner in which interest will be handled by the system. During a trading halt, the market may move and create risk to market participants with respect to resting interest. The Exchange believes that cancelling existing quotes protects investors and the public interest by removing potentially stale quotes during the halt process.

The Exchange's proposal to amend its rules on order handling during Limit up-Limit Down states and trading halts is consistent with the Act because it will harmonize the way the Exchange treats orders during a Limit State or Straddle State in the equity market, or a trading halt in the option, with how those orders are handled on other Nasdaq Exchanges. The proposed rule text should provide certainty about how options orders and trades will be handled during periods of extraordinary volatility in the underlying

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<sup>37</sup> 15 U.S.C. 78f(b).

<sup>38</sup> 15 U.S.C. 78f(b)(5).

security. Specifically, under the proposal, market participants will be able to continue to trade options overlying securities that are in a Limit State or Straddle State, while addressing specific order types that are subject to added risks during such periods. The Exchange believes that the rejection of options Market Orders (including elected Stop Orders) should help to prevent executions that might occur at prices that have not been reliably formed, which should, in turn, protect, in particular, retail investors from executions of un-priced orders during times of significant volatility. Specifically, with respect to Market Orders, Market Orders exposed at the NBBO pursuant to Supplementary Material .02 to ISE Rule 1901 or exposed for price improvement pursuant to ISE Rule 722(b)(3)(iii), which are pending in the system, will continue to be processed. The Exchange believes that it is consistent with the Act to cancel a Market Order, if at the end of either of these exposure periods the affected underlying is in a Limit or Straddle State, because of the uncertainty present which may result in executions that might occur at prices that have not been reliably formed. The Exchange would process the Market Order, with normal handling, provided the affected underlying is no longer in a Limit or Straddle State. The Exchange believes that this approach should, in turn, protect, in particular, retail investors from executions of un-priced orders during times of significant volatility. The Exchange believes that harmonizing these rules will provide a better experience to members that trade on multiple markets operated by Nasdaq, Inc.

### **Cancellation of Quotes**

The Exchange's proposal to amend ISE Rule 702 concerning Trading Halts to specifically note that during a halt the Exchange will maintain existing orders on the book but not existing quotes is consistent with the Act because it provides market participants

with clarity as to the manner in which interest will be handled by the system. During a trading halt, the market may move and create risk to market participants with respect to resting interest. The Exchange believes that cancelling existing quotes protects investors and the public interest by removing potentially stale quotes during the halt process.

### **Limit Up-Limit Down**

The Exchange's proposal to add new ISE Rule 702(d) to replace rule text currently contained in ISE Rule 703A entitled "Trading During Limit Up-Limit Down States in Underlying Securities" is consistent with the Act because the proposed rules provide for protections from erroneous executions in a highly volatile period. The proposed rule text in ISE Rule 702(d) is similar to language currently in Phlx Rule 1047(d), which provides for Exchange handling due to extraordinary market volatility. As noted within this proposal, the Exchange will adopt opening limitation, Market Order and Stop Order handling consistent with handling today on Phlx. The Exchange proposes to adopt rule text to provide for how the Exchange shall treat the opening rotation.<sup>39</sup> If an opening process is occurring, it will cease and then start the opening process from the beginning once the Limit State or Straddle State is no longer occurring. The Exchange believes that this treatment at the opening will protect investors and the public interest by halting trading to prevent unintended executions. Also, with this proposal, Market Orders pending in the System will continue to be processed regardless of the Limit or Straddle State. The Exchange believes that this treatment of Market Orders is consistent with the Act because these Market Orders are only pending in the System if they are exposed at the NBBO pursuant to Supplementary Material .02 to ISE Rule 1901 or a

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<sup>39</sup> See note 3 above.

complex order exposed for price improvement pursuant to ISE Rule 722(b)(3)(iii). If at the end of the exposure period the affected underlying is in a Limit or Straddle State, the Market Order will be cancelled with no trade occurring. If at the end of the exposure period, the affected underlying is no longer in a Limit or Straddle State, the Market Order will be handled pursuant to the normal operation of the rules.

Lastly, ISE does not currently elect Stop Orders that are pending in the System during a Limit or Straddle State. Under the proposal, and in-line with the Phlx implementation, Stop Orders that are pending in the System during a Limit or Straddle State will be elected, if conditions for such election are met, and, because they become Market Orders, will be cancelled back to the Member with a reason for such rejection. The Exchange believes that this is consistent with the Act because it affords the appropriate protections to an elected Stop Order once it becomes a Market Order after election. The Exchange believes that this approach provides the market participant with the intended result.

#### **Auction Handling During a Trading Halt**

The Exchange's proposal to amend various rules to add detail to ISE rules to account for the impact of a trading halt on the Exchange's auction mechanisms is consistent with the Act for the reasons which follow. The Exchange's proposal to amend today's current behavior and instead terminate the auction and not execute eligible interest when a trading halt occurs is consistent with the Act because during a trading halt, the market may move and create risk to market participants with respect to resting interest. The Exchange believes that terminating the PIM auction protects investors and the public interest by providing certainty to participants in regard to how their interest will be handled. Introducing consistent order handling and memorializing the manner in

which the system will handle orders entered into PIM during a trading halt will provide transparency for the benefit of members and investors.

The Exchange's proposal to amend ISE Rule 716, entitled "Block Trades" to memorialize that if a trading halt is initiated after an order is entered into the Block Order Mechanism, Facilitation Mechanism, or Solicited Order Mechanism, such auction will also be automatically terminated without execution is consistent with the Act because in the event of a trading halt, terminating these auction mechanisms and not executing eligible interest will provide certainty to participants in regard to how their interest will be handled. Memorializing the manner in which the system will handle orders during a trading halt will provide transparency for the benefit of members and investors.

#### **Market Order Spread Protection**

The Exchange's proposal to amend ISE Rule 711 to adopt a mandatory risk protection entitled Market Order Spread Protection for single leg orders is consistent with the Act because it provides a protection for Market Orders that may encourage price continuity, which should, in turn, protect investors and the public interest by reducing executions occurring at dislocated prices. Further, the Exchange believes that this rule proposal will mitigate risks to market participants.

#### **Acceptable Trade Range**

The Exchange's proposal to amend ISE Rule 714 to remove the current Price Level Protection rule and adopt Phlx's Acceptable Trade Range for single leg orders is consistent with the Act and will 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 by making the Exchange's market more efficient, to the benefit of the investing public. Further, it should prevent the system from experiencing dramatic



price swings by creating a level of protection that prevents the market from moving beyond set thresholds. The proposed rule change will reduce the negative impacts of sudden, unanticipated volatility in individual options, and serve to preserve an orderly market in a transparent and uniform manner, enhance the price-discovery process, increase overall market confidence, and promote fair and orderly markets and the protection of investors. Specifically, the Exchange believes that the NBBO is a fair representation of then-available prices and accordingly the proposal helps to avoid executions at prices that are significantly worse than the NBBO.

With respect to the posting information, which is described in the Phlx rule, but not contained in the proposed ISE rule, the Exchange believes that it is consistent with the Act to cancel unexecuted interest which is priced through an Acceptable Trade Range. Today, the Exchange does not have an iterative process wherein the Exchange will attempt to execute unexecuted balances for a period of time while that interest is automatically re-priced on the order book. Phlx has this type of functionality for Acceptable Trade Range, while the Exchange does not re-price interest on the order book. The Exchange transparently describes the cancellation of the interest within its rules.

The Exchange's proposal to amend the current Price Level Protection Rule in Rule 714(b)(1) to relocate the provision to Rule 714(b)(4) and remove references to PMM Order Handling is consistent with the Act because the Exchange will continue to offer this protection for complex orders. Unlike single leg orders which are subject to trade-through protections, complex orders do not have similar restrictions and therefore the Exchange believes that the current Price Level Protection Rule provides a better

protection for complex orders because the Acceptable Trade Range protection described within this filing utilizes the NBBO and the Price Level Protection does not rely on the NBBO but rather limits the number of price levels.

### **PMM Order Handling and Opening Obligations**

The Exchange's proposal to eliminate the PMMs order handling and opening obligations is consistent with the Act because PMMs will no longer have these obligations due to the introduction of Acceptable Trade Range and opening rotation functionality that is offered today on NOM and Phlx. Because the PMM will no longer have these obligations, the Exchange believes that it is appropriate to remove these rules.

### **Back-Up PMM**

The Exchange's proposal to remove certain responsibilities of Primary Market Makers with respect to Back-Up Primary Market Maker assignments is consistent with the Act because the Exchange believes this function is not necessary. Today, in addition to market making obligations, the Primary Market Maker has certain order handling and other obligations as prescribed by Exchange Rules. Specifically, the obligations of a Primary Market Maker include the initiation of a trading rotation pursuant to ISE Rule 701, quoting and other obligations pursuant to ISE Rules 803 and 804, and financial requirements pursuant to ISE Rule 809. The Exchange is proposing to amend the obligations of a PMM only with regard to the initiation of a trading rotation pursuant to ISE Rule 701. The quoting and financial requirements rules shall remain the same. With the re-platform, a Back-Up Primary Market Maker is no longer necessary since the order handling obligations present on ISE today are not going to be present in the new system.

Furthermore, the proposed Opening Process,<sup>40</sup> obviates the importance of such a role. The Opening Process further describes alternative methods to open the market if such quotes are not entered at the opening by either of these market makers.<sup>41</sup> The reliance on a market maker to initiate the opening process is no longer present within the proposed rule.<sup>42</sup>

In addition, the Exchange does not believe there is an interest among market participants for the back-up assignment.

### **Default Settings for Market Maker Risk Protections**

The Exchange's proposal to amend ISE Rule 804(g) to introduce default curtailment settings for the Market Maker Speed Bump and Market-Wide Speed Bump is consistent with the Act as it will allow market makers to use Exchange set default values for these risk protections. Today, these market makers would have their quotes rejected if they fail to enter the required curtailment parameters. The default settings provide an alternative for market makers that have not entered their curtailment settings. Default settings will be announced to members who will have the opportunity to avoid the defaults by entering their own curtailment settings as required under the rule.

### **Anti-Internalization**

The Exchange's proposal to amend the ISE Supplementary Material at .03 to Rule 804 to add Anti-Internalization is consistent with the Act because it is designed to assist market makers in reducing trading costs from unwanted executions potentially resulting

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<sup>40</sup> See note 3 above.

<sup>41</sup> Id.

<sup>42</sup> Id.

from the interaction of executable buy and sell trading interest from the same firm when performing the same market making function. Further, it is consistent with the Act to not apply this functionality in any auction or with respect to complex transactions because AIQ is difficult to apply during auctions, and there is limited benefit in doing so. There is limited benefit because, generally speaking, auctions do not raise the same policy concerns for wash sales and ERISA<sup>43</sup> due to the semi-random manner in which trades are matched. AIQ is unnecessary with respect to complex orders due to the highly specialized nature of such orders and the high level of control that market participants exercise over complex orders.

#### **Minimum Quantity Orders**

The Exchange believes that removing minimum quantity orders would remove impediments to and perfect the mechanism of a free and open market and a national market system by simplifying functionality available on the Exchange and reducing complexity of its order types.

#### **Delay of Implementation**

The Exchange believes that delaying the implementation of the Directed Order functionality on ISE is consistent with the Act because the Exchange desires to rollout this functionality at a later date to allow additional time to rebuild this technology on the new platform. The Exchange is staging the replatform to provide maximum benefit to its Members while also ensuring a successful rollout. This delay will provide the Exchange additional time to implement this functionality, which is not being amended. Members will be given adequate notice of the implementation dates. The Exchange will continue

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<sup>43</sup> See note 34 above.

to provide notifications to Members to ensure clarity about the delay of implementation of this functionality. The Exchange will note the applicable dates within the rule text.

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. As explained above, the Exchange is re-platforming its trading system onto the Nasdaq INET architecture, and is making certain other changes to its trading functionality in connection with this migration. A majority of the functionality that is being added with the proposed rule change already exists on one or more Nasdaq Exchanges. As a result, the Exchange does not believe that the proposed rule change will impact the intense competition that exists in the options market. In fact, the Exchange believes that adopting this functionality on ISE will allow the Exchange to more effectively compete for order flow with other options markets.

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

No written comments were either solicited or received.

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

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

#### IV. Solicitation of Comments

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

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-ISE-2017-03 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-ISE-2017-03. 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 Web site (<http://www.sec.gov/rules/sro.shtml>).

Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing

also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-ISE-2017-03 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>44</sup>

Robert W. Errett  
Deputy Secretary

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<sup>44</sup> 17 CFR 200.30-3(a)(12).

**EXHIBIT 5****INTERNATIONAL SECURITIES EXCHANGE  
RULES**

*New text is underlined; deleted text is in brackets.*

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**CHAPTER 7  
Doing Business On The Exchange**

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**Rule 702. Trading Halts**

(a) *Halts.* An Exchange official designated by the Board may halt trading in any stock option in the interests of a fair and orderly market.

(1) and (2) No change.

(3) A designated Exchange official may halt trading (including a rotation) for a class or classes of options contracts whenever there is a halt of trading in an underlying security in one or more of the markets trading the underlying security. In such event, without the need for action by the Primary Market Maker, all trading in the effected class or classes of options may be halted. The Exchange shall disseminate through its trading facilities and over OPRA a symbol in respect of such class or classes of options indicating that trading has been halted, and a record of the time and duration of the halt shall be made available to vendors. Similarly, a designated Exchange official will halt trading for an Equity Security whenever there is a halt of trading in that security in the primary market. During a halt, the Exchange will maintain existing orders on the book (but not existing quotes prior to the halt), accept orders and quotes, and process cancels and modifications, except existing quotes are cancelled.

(4) No change.

(b) and (c) No change.

(d) This paragraph shall be in effect during a pilot period to coincide with the pilot period for the Plan to Address Extraordinary Market Volatility Pursuant to Rule 608 of Regulation NMS, as it may be amended from time to time (“LULD Plan”). Capitalized terms used in this paragraph shall have the same meaning as provided for in the LULD Plan. During a Limit State and Straddle State in the Underlying NMS stock:

(1) The Exchange will not open an affected option.



(2) Provided the Exchange has opened an affected option for trading, the Exchange shall reject Market Orders, as defined in Rule 715(a) (including complex orders) and shall notify Members of the reason for such rejection. The Exchange shall cancel complex orders that are Market Orders residing in the System if they are about to be executed by the System. Market Orders exposed at the NBBO pursuant to Supplementary Material. 02 to ISE Rule 1901 or exposed for price improvement pursuant to ISE Rule 722(b)(3)(iii), pending in the System, will continue to be processed. If at the end of the exposure period the affected underlying is in a Limit or Straddle State, the Market Order will be cancelled. If the affected underlying is no longer in a Limit or Straddle State after the exposure period, the Market Order will be processed with normal handling.

(3) Provided the Exchange has opened an affected option for trading, the Exchange shall elect Stop Orders if the condition as provided in Rule 715(d) is met, and, because they become Market Orders, shall cancel them back and notify Members of the reason for such rejection.

(4) When the security underlying an option class is in a Limit State or Straddle State, the maximum quotation spread requirements for market maker quotes contained in Rule 803(b)(4) and the continuous quotation requirements contained in Rule 804(e) shall be suspended. The time periods associated with Limit States and Straddle States will not be considered by the Exchange when evaluating whether a market maker complied with the continuous quotation requirements contained in Rule 804(e).

### ***Supplementary Material to Rule 702***

.01 No change.

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### **[Rule 703A. Trading During Limit Up-Limit Down States in Underlying Securities**

(a) Definitions: For purposes of this Rule 703A:

(1) The term “limit up-limit down” shall mean the procedures applicable to the trading of equity securities that underlie options traded on the Exchange that prevent trades in individual equity securities from occurring outside of specified price bands.

(2) The term “Limit State” shall mean the condition when the national best bid or national best offer for an underlying security equals an applicable price band, as determined by the primary listing exchange for the underlying security.

(3) The term “Straddle State” shall mean the condition when the national best bid or national best offer for an underlying security is non-executable, as determined by the

primary listing exchange for the underlying security, but the security is not in a Limit State.

(b) Order Handling: When a security underlying an options class traded on the Exchange enters a Limit State or Straddle State, trading shall continue on the Exchange with the following modified order handling procedures:

(1) Market Orders. All incoming market orders will be automatically rejected during a Straddle State or Limit State, and all unexecuted market orders pending in the System will be automatically canceled upon the initiation of a Limit State or Straddle State.

(2) Stop Orders. Incoming stop orders will be automatically rejected during a Limit State or Straddle State, and all unexecuted stop orders pending in the System cannot be elected during a Limit State or Straddle State. Such order will be held until the end of a Limit State or Straddle State, at which point the order will become eligible to be elected if the market for the particular option contract reaches the specified contract price.

(c) Market Maker Obligations: When the security underlying an option class is in a Limit State or Straddle State, the maximum quotation spread requirements for market maker quotes contained in Rule 803(b)(5) and the continuous quotation requirements contained in Rule 804(e) shall be suspended. The time periods associated with Limit States and Straddle States will not be considered by the Exchange when evaluating whether a market maker complied with the continuous quotation requirements contained in Rule 804(e).]

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### **Rule 711. Acceptance of Quotes and Orders**

(a) All bids or offers made and accepted on the Exchange in accordance with the Rules shall constitute binding contracts, subject to applicable requirements of the Constitution and the Rules and the rules of the Clearing Corporation.

(b) A trade may be nullified if all parties participating in the trade agree to the nullification. In such case, one party must notify the Exchange and the Exchange promptly will disseminate the nullification to OPRA.

(c) Market Order Spread Protection. Market Orders will be rejected for single leg orders if the NBBO is wider than a preset threshold at the time the order is received by the trading system.

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### **Rule 713. Priority of Quotes and Orders**

(a) – (f) No change

***Supplementary Material to Rule 713***

.01 No change.

.02 All-or-none orders, as defined in Rule 715(c), [and minimum quantity orders, as defined in Rule 715(l),]are contingency orders that have no priority on the book. Such orders are maintained in the system and remain available for execution after all other trading interest at the same price has been exhausted.

.03 – .04 No change.

**Rule 714. Automatic Execution of Orders**

Incoming orders that are executable against orders and quotes in the System will be executed automatically by the System subject to the following:

(a) No change.

(b) Other Order Protections. Subject to the NBBO price protection in (a) above, the following additional order protections are automatically enforced by the System:

(1) Acceptable Trade Range. The following shall apply for single leg orders:  
[Price Level Protection. There is a limit on the number of price levels at which an incoming order to sell (buy) will be executed automatically when there are no bids (offers) from other exchanges at any price for the options series. Orders are executed at each successive price level until the maximum number of price levels is reached, and any balance is either handled by the Primary Market Maker pursuant to Rule 803(c)(1) (in the case of Priority Customer Orders) or canceled (in the case of Professional Orders). The number of price levels, which may be between one (1) and ten (10), is determined by the Exchange from time-to-time on a class-by-class basis.]

(i) The system will calculate an Acceptable Trade Range to limit the range of prices at which an order or quote will be allowed to execute. The Acceptable Trade Range is calculated by taking the reference price, plus or minus a value to be determined by the Exchange (i.e., the reference price - (x) for sell orders/quotes and the reference price + (x) for buy orders or quotes). Upon receipt of a new order or quote, the reference price is the NBB for sell orders/quotes and the NBO for buy orders/quotes. The Acceptable Trade Range will not be available for all-or-none orders.

(ii) If an order or quote reaches the outer limit of the Acceptable Trade Range without being fully executed then any unexecuted balance will be cancelled.

(iii) There will be three categories of options for Acceptable Trade Range: (1) Penny Pilot Options trading in one cent increments for options trading at less than \$3.00 and increments of five cents for options trading at \$3.00 or more, (2) Penny Pilot Options trading in one-cent increments for all prices, and (3) Non-Penny Pilot Options.

(2) – (3) No change.

(4) Price Level Protection. This protection shall apply to complex orders. There is a limit on the number of price levels at which an incoming order or quote to sell (buy) will be executed automatically with the bids or offers of each component leg. Orders and quotes are executed at each successive price level until the maximum number of price levels is reached, and any balance is canceled. The number of price levels for the component leg, which may be between one (1) and ten (10), is determined by the Exchange from time-to-time on a class-by-class basis.

(c) and (d) No change.

#### **Rule 715. Types of Orders**

(a) – (p) No change.

(q) Reserved.[Minimum Quantity Order. A Minimum Quantity Order is an order that is initially available for partial execution only for a specified number of contracts or greater. A member may specify whether any subsequent executions of the order must also be for the specified number of contracts or greater, or if the balance may be executed as a regular order. If all executions are to be for the specified number of contracts or greater and the balance of the order after one or more partial execution(s) is less than the minimum, such balance is treated as all-or-none.]

(r) and (s) No change.

#### ***Supplementary Material to Rule 715***

.01 No change.

#### **Rule 716. Block Trades**

(a) – (b) No change.

(c) *Block Order Mechanism.* The Block Order Mechanism is a process by which a Member can obtain liquidity for the execution of block-size orders.

(1) No change.

(2) No change.

(i) and (ii) No change.

(3) If a trading halt is initiated after an order is entered into the Block Order Mechanism, such auction will be automatically terminated without execution.

(d) *Facilitation Mechanism.* The Facilitation Mechanism is a process by which an Electronic Access Member can execute a transaction wherein the Electronic Access Member seeks to facilitate a block-size order it represents as agent, and/or a transaction wherein the Electronic Access Member solicited interest to execute against a block-size order it represents as agent. Electronic Access Members must be willing to execute the entire size of orders entered into the Facilitation Mechanism.

(1) – (2) No change.

(3) At the end of the period given for the entry of Responses, the facilitation order will be automatically executed.

(i) – (iii) No change.

(iv) If a trading halt is initiated after an order is entered into the Facilitation Mechanism, such auction will be automatically terminated without execution.

(e) *Solicited Order Mechanism.* The Solicited Order Mechanism is a process by which an Electronic Access Member can attempt to execute orders of 500 or more contracts it represents as agent (the “Agency Order”) against contra orders that it solicited. Each order entered into the Solicited Order Mechanism shall be designated as all-or-none.

(1) No change.

(2) At the end of the period given Members to enter Responses, the Agency Order will be automatically executed in full or cancelled.

(i) – (iii) No change.

(iv) If a trading halt is initiated after an order is entered into the Solicited Order Mechanism, such auction will be automatically terminated without execution.

(3) No change.

***Supplementary Material to Rule 716***

.01 - .09 No change.

**Rule 717. Limitations on Orders**

(a) – (g) No change.

***Supplementary Material to Rule 717***

.01 – .03 No change.

.04 Non-marketable all-or-none limit orders [and non-marketable minimum quantity orders] shall be deemed “exposed” for the purposes of paragraphs (d) and (e) one second following a broadcast notifying market participants that such an order to buy or sell a specified number of contracts at a specified price [either as] all-or-none [or with a specified minimum quantity] has been received in the options series. [For non-marketable minimum quantity orders, the broadcast will specify the minimum quantity that can be executed.]

.05 - .06 No change.

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**Rule 723. Price Improvement Mechanism for Crossing Transactions**

(a) – (c) No Change.

(d) Execution. At the end of the exposure period the Agency Order will be executed in full at the best prices available, taking into consideration orders and quotes in the Exchange market, Improvement Orders, and the Counter-Side Order. The Agency Order will receive executions at multiple price levels if there is insufficient size to execute the entire order at the best price.

(1) – (4) No change.

(5) If a trading halt is initiated after an order is entered into the Price Improvement Mechanism, such auction will be automatically terminated without execution.

***Supplementary Material to Rule 723***

.01 - .10 No change.

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**Chapter 8 Market Makers**

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**Rule 803. Obligations of Market Makers**

(a) and (b) No change.

(c) Reserved.[*Primary Market Makers.* In addition to the obligations contained in this Rule for market makers generally, for options classes to which a market maker is the appointed Primary Market Maker, it shall have the responsibility to:

(1) As soon as practical, address Priority Customer Orders that are not automatically executed pursuant to Rule 714(b)(1) in a manner consistent with its obligations under paragraph (b) of this Rule by either (i) executing all or a portion of the order at a price that at least matches the NBBO and that improves upon the Exchange's best bid (in the case of a sell order) or the Exchange's best offer (in the case of a buy order); or (ii) releasing all or a portion of the order for execution against bids and offers on the Exchange.

(2) Initiate trading in each series pursuant to Rule 701.]

(d) No change.

***Supplementary Material to Rule 803***

.01 and .02 No change

[.03 Any Member that is approved to act in the capacity of a Primary Market Maker or an "Alternative Primary Market Maker" may voluntarily act as a "Back-Up Primary Market Maker" in options series in which it is quoting as a Competitive Market Maker.

(a) A Back-Up Primary Market Maker assumes all of the responsibilities and privileges of a Primary Market Maker under the Rules with respect to any series in which the appointed Primary Market Maker fails to have a quote in the System except that a Back-Up Primary Market Maker's quoting obligations are the same as the quoting obligations for Competitive Market Makers as described in Rule 804(e)(2)(iii) and .02 of Supplementary Material to Rule 804.

(b) In the event a Primary Market Maker ceases quoting, the System will choose a Back-Up Primary Market Maker, from the available Competitive Market Makers, to replace the Primary Market Maker. If more than one Competitive Market Maker has volunteered to be a Back-Up Primary Market Maker and is quoting in the options series at the time that a Primary Market Maker ceases quoting, the System will choose the Competitive Market Maker with the lowest offer price in the series at that time. If there are two or more Competitive Market Makers at the same offer price, the Competitive Market Maker with the highest bid price will be chosen. If there are two or more Competitive Market Makers at the same bid and offer price, the Competitive Market Maker with the largest offer quantity will be chosen. If there are two or more Competitive

Market Makers with the same offer quantity, the Competitive Market Maker with the largest bid quantity will be chosen. If there remains two or more Competitive Market Makers with the same bid and offer quantity and prices, the one with the highest time priority on the offer will be chosen as the Back-Up Primary Market Maker.

(c) The Back-Up Primary Market Maker is automatically restored to Competitive Market Maker status when the appointed Primary Market Maker initiates quoting in the series.]

#### **Rule 804. Market Maker Quotations**

(a) – (f) No change.

(g) *Automated Quotation Adjustments.*

(1) A market maker must provide parameters by which the Exchange will automatically remove a market maker's quotations in all series of an options class. If a market maker does not provide parameters then the Exchange will apply default parameters announced to members. The Exchange will automatically remove a market maker's quotation when, during a time period established by the market maker, the market maker exceeds: (i) the specified number of total contracts in the class, (ii) the specified percentage of the total size of the market maker's quotes in the class, (iii) the specified absolute value of the net between contracts bought and contracts sold in the class, or (iv) the specified absolute value of the net between (a) calls purchased plus puts sold in the class, and (b) calls sold plus puts purchased in the class.

(2) A market maker must provide a market wide parameter by which the Exchange will automatically remove a market maker's quotes in all classes when, during a time period established by the market maker, the total number of quote removal events specified in Rule 804(g)(1) and in Supplementary Material .04 to Rule 722 exceeds the market wide parameter provided to the Exchange by the market maker. Market makers may request the Exchange to set the market wide parameter to apply to just ISE or across ISE and ISE Gemini. If a market maker does not provide parameters then the Exchange will apply default parameters announced to members.

(h) No change.

#### ***Supplementary Material To Rule 804***

.01 and .02 No change.

**03. Anti-Internalization** - Notwithstanding Rule 804(d)(1) above, quotes and orders entered by Market Makers using the same member identifier will not be executed against quotes and orders entered on the opposite side of the market by the same market maker using the same member identifier. In such a case, the system will cancel the resting quote



or order back to the entering party prior to execution. This functionality shall not apply in any auction or with respect to complex transactions.

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**Rule 811. Directed Orders**

**Directed Order functionality will not be available as of a certain date in the second quarter of 2017 to be announced in a notice. The Exchange will recommence Directed Order functionality on ISE within one year from the date of the filing of SR-ISE-2017-03 to be announced in a separate notice.**

(a) – (e) No change.

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