

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–101720; File No. SR–ISE–2024–12]

Self-Regulatory Organizations; Nasdaq ISE, LLC; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, To Adopt Rules To List and Trade FLEX Options

November 22, 2024.

On March 11, 2024, Nasdaq ISE, LLC (“ISE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b–4 thereunder,² a proposed rule change to adopt new Options 3A that will govern the listing and trading of Flexible Exchange Options (“FLEX Options”) on the Exchange’s electronic market. The proposed rule change was published for comment in the **Federal Register** on March 29, 2024.³

On May 9, 2024, pursuant to Section 19(b)(2) of the Exchange Act,⁴ the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.⁵ On June 26, 2024, the Commission instituted proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act⁶ to determine whether to approve or disapprove the proposed rule change.⁷ On September 20, 2024, the Commission designated a longer period for Commission action on the proposed rule change.⁸ On November 20, 2024, the Exchange submitted Amendment No. 1 to the proposed rule change,

which replaced and superseded the proposed rule change as originally filed.⁹ The Commission is publishing this notice to solicit comments on Amendment No. 1 from interested persons, and is approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

I. Self-Regulatory Organization’s Description of the Proposed Rule Change, as Modified by Amendment No. 1¹⁰

The Exchange proposes to adopt rules that will govern the listing and trading of flexible exchange options (“FLEX Options”). This Amendment No. 1 supersedes the original filing in its entirety.

The text of the proposed rule change is available on the Exchange’s website at <https://listingcenter.nasdaq.com/rulebook/ise/rules>, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The Exchange proposes to adopt rules in new Options 3A that will govern the listing and trading of FLEX Options on the Exchange’s electronic market. This Amendment No. 1 supersedes the original filing in its entirety, and is being filed to better align the proposed rule change with the rules of other exchanges and provide more clarity to the proposed rule text as well as the description of and statutory basis for the proposed rule change. As discussed in further detail later in this filing,

Amendment No. 1 makes a number of clarifying changes to the proposed rule text as well as the following more substantive rule text changes from the original filing: (i) excluding the iShares Bitcoin Trust ETF from FLEX trading in proposed Options 3A, Section 3(a); (ii) clarifying in proposed Options 3A, Section 3(b)(2) that on the expiration date, a FLEX Order for the expiring FLEX Option series may only be submitted to close out a position in such expiring FLEX Option series; (iii) aligning the Exchange’s closing only provisions in proposed Options 3A, Section 3(d)(2) to already effective rules of other options exchanges; (iv) clarifying in proposed Options 3A, Section 5 which provisions will govern how the minimum increments for complex FLEX Orders (including complex FLEX Orders with a stock component) will be handled; (v) clarifying in proposed Options 3A, Sections 6(a) and 6(b) that only the specified order types, times-in-force, and order and quote protocols are available for FLEX trading; (vi) removing in proposed Options 3A, Section 7(b) the Exchange’s discretion to determine on a class-by-class basis which complex FLEX Orders would not have to adhere to the ratio requirements for the standard complex market; (vii) adding language in proposed Options 3A, Section 11(a)(2)(A) to describe what would happen if there is a complex FLEX Order and subsequently, a non-FLEX Option series is introduced for the component leg(s), which would align to already effective rules of another options exchange; (viii) adding language in proposed Options 3A, Sections 12(a)(2) and 13(a)(2) that each leg of a complex FLEX Order must be in a permissible FLEX option series that complies with proposed Options 3; (ix) specifying in proposed Options 3A, Section 13(a)(4) that the minimum size requirement will apply to each leg of a complex FLEX Order; (x) adding in proposed Options 3A, Section 14(b) that the Price Limit for Complex Order protections as applicable to the stock component, the Stock-Tied NBBO protections, and the Stock-Tied Reg SHO protections will also be available to FLEX Options as complex order risk protections; and (xi) aligning the proposed position limits for FLEX Index Options in proposed Options 3A, Section 18(a) with the position limits for index options in the Exchange’s standard index options market.

The Exchange notes that Amendment No. 1 is solely intended to further clarify the proposed rule text and conform the rule text with the already

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b–4.

³ See Securities Exchange Act Release No. 99825, 89 FR 22294 (March 29, 2024) (“Notice”). Comments on the proposed rule change can be found at: <https://www.sec.gov/comments/sr-ise-2024-12/srise202412.htm>.

⁴ 15 U.S.C. 78s(b)(2).

⁵ See Securities Exchange Act Release No. 100086, 89 FR 42528 (May 15, 2024). The Commission designated June 27, 2024, as the date by which the Commission shall approve or disapprove, or institute proceedings to determine whether to approve or disapprove, the proposed rule change.

⁶ 15 U.S.C. 78s(b)(2)(B).

⁷ See Securities Exchange Act Release No. 100438, 89 FR 54886 (July 2, 2024) (Notice of Order Instituting Proceedings) (“OIP”).

⁸ See Securities Exchange Act Release No. 101116 (September 20, 2024), 89 FR 78928 (September 26, 2024) (Extension No. 2). The Commission designated November 24, 2024, as the date by which the Commission shall approve or disapprove the proposed rule change.

⁹ On November 20, 2024, the Exchange submitted Amendment No. 1 to the proposed rule change. Amendment No. 1 is available on the Commission’s website at: <https://www.sec.gov/comments/sr-ise-2024-12/srise202412-541455-1551502.pdf> (“Amendment No. 1”).

¹⁰ This Section I and II reproduces Amendment No. 1, as filed by the Exchange.

established rules of other exchanges, and to provide additional detail and specificity with respect to the proposed rule change and additional information in support of the purpose and statutory basis for the proposed rule change.

Summary

The Exchange is proposing this new functionality be implemented in connection with a technology migration to enhanced Nasdaq, Inc. (“Nasdaq”) functionality that will result in higher performance, scalability, and more robust architecture, which will be implemented as a day 2 change after the first phase of the system migration was implemented in September 2024.¹¹ The Exchange intends to begin implementation of the proposed rule change by May 12, 2025. The delayed implementation of the proposed FLEX rules will ensure that the Exchange will have the necessary functionality in place to trade FLEX. The Exchange will issue a public notice to Exchange members (“Members”) to provide notification of the FLEX implementation date and highlight the features for FLEX proposed hereunder.

As proposed, FLEX Options will be customized options contracts that will allow investors to tailor contract terms for exchange-listed equity and index options. FLEX Options will be designed to meet the needs of investors for greater flexibility in selecting the terms of options within the parameters of the Exchange’s proposed rules. FLEX Options will not be preestablished for trading and will not be listed individually for trading on the Exchange. Rather, investors will select FLEX Option terms and will be limited by the parameters detailed below in their selection of those terms. As a result, FLEX Options would allow investors to specify more specific, individualized investment objectives

than may be available to them in the standardized options market.

Some key features of the new electronic FLEX Options functionality are as follows:

- **System Availability:** The Exchange will not conduct an Opening Process pursuant to Options 3, Section 8 in FLEX Options.¹² Orders in FLEX Options may only be submitted through an electronic FLEX Auction, a FLEX Price Improvement Auction (“FLEX PIM”), or a FLEX Solicited Order Mechanism (“FLEX SOM”), each as discussed in detail below.¹³ Accordingly, the Exchange’s simple and complex order books will not be available for transactions in FLEX Options.¹⁴

- **Terms:** FLEX Options will be a type of put or call, and will allow investors the flexibility to choose an exercise style of American or European, an expiration date, a settlement type, and an exercise price, all within the parameters specified in the proposed rules.¹⁵ As discussed further below, FLEX Options will not be permitted with identical terms as an existing non-FLEX Option series listed on the Exchange.¹⁶

- **Priority:** As discussed in detail below within the respective sections for FLEX Auctions, FLEX PIM, and FLEX SOM, the Exchange will apply the same priority order for FLEX Options as it applies today in its standard non-FLEX market, particularly in its standard auction mechanisms such as its standard Solicited Order Mechanism and standard Price Improvement Mechanism. Specifically, the System¹⁷ shall execute trading interest at the best price level within the System before executing at the next best price. Priority Customers shall have priority over non-Priority Customer interest at the same price with time priority meaning that priority shall be afforded to Priority Customer orders in the sequence in

which they are received by the System. As set out in Options 1, Section 1(a)(37), the term “Priority Customer” means a person or entity that (i) is not a broker or dealer in securities, and (ii) does not place more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s).

Because of their composition, the Exchange believes that FLEX Options may allow investors to more closely meet their individual investment and hedging objectives by customizing options contracts for the purpose of satisfying particular investment objectives that could not be met by the standardized markets.

Background

The Commission approved the trading of FLEX Options in 1993.¹⁸ At the time, the Chicago Board Options Exchange, Inc., now Cboe Exchange, Inc. (“Cboe”), proposed FLEX Options based on the Standard and Poor’s Corporation 500 and 100 Stock Indexes.¹⁹ These FLEX Options were offered as an alternative to an over-the-counter (“OTC”) market in customized equity options.²⁰ Several years after the initial approval, the Commission approved the trading of additional FLEX Options on specified equity securities.²¹ In its order, the Commission provided: “The benefits of the Exchanges’ options markets include, but are not limited to, a centralized market center, an auction market with posted transparent market quotations and transaction reporting, parameters and procedures for clearance and settlement, and the guarantee of the OCC [Options Clearing Corporation] for all contracts traded on the Exchange.”²²

The Exchange notes that FLEX Options are currently traded on Cboe, NYSE American LLC (“NYSE American”), NYSE Arca, Inc. (“NYSE

¹¹ The Exchange separately proposed a number of rule filings in connection with this technology migration. See Securities Exchange Act Release Nos. 94897 (May 12, 2022), 87 FR 30294 (May 18, 2022) (SR-ISE-2022-11); 96362 (November 18, 2022), 87 FR 72539 (November 25, 2022) (SR-ISE-2022-25); 96518 (December 16, 2022), 87 FR 78740 (December 22, 2022) (SR-ISE-2022-28); 96818 (February 6, 2023), 88 FR 8950 (February 10, 2023) (SR-ISE-2023-06); 97605 (May 26, 2023), 88 FR 36350 (June 2, 2023) (SR-ISE-2023-10); 98066 (August 7, 2023), 88 FR 54672 (August 11, 2023) (SR-ISE-2023-13); 98443 (September 20, 2023), 88 FR 66106 (September 26, 2023) (SR-ISE-2023-19); and 98702 (October 6, 2023), 88 FR 71046 (October 13, 2023) (SR-ISE-2023-22). As per the previously announced technology migration, ISE completed its symbol migration on September 23, 2024. See <https://www.nasdaqtrader.com/MicroNews.aspx?id=OTA2024-1>. As a result and prior to any FLEX trading on ISE, the foregoing rule changes are currently all effective and operative.

¹² See proposed Options 3A, Section 8(a). Rather, Members may begin submitting orders in FLEX Options into one of the proposed auction mechanisms (i.e., electronic FLEX Auction, FLEX Price Improvement Mechanism, and FLEX Solicited Order Mechanism) once the underlying security is open for trading. See proposed Options 3A, Section 8(b).

¹³ See proposed Options 3A, Section 11(a).

¹⁴ See proposed Options 3A, Section 10(a).

¹⁵ As discussed later in this filing, proposed Options 3A, Section 3(c) will govern FLEX Options terms.

¹⁶ At least one of the following terms must differ between FLEX Options and non-FLEX Options on the same underlying security: exercise date, exercise price, or exercise style. See proposed Options 3A, Section 3(c).

¹⁷ The term “System” means the electronic system operated by the Exchange that receives and disseminates quotes, executes orders and reports transactions. See Options 1, Section 1(a)(50).

¹⁸ See Securities Exchange Act Release No. 31920 (February 24, 1993), 58 FR 12280 (March 3, 1993) (SR-CBOE-92-17) (Order Approving and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 1, 2, 3, and 4 to Proposed Rule Changes by the Chicago Board Options Exchange, Inc., Relating to FLEX Options).

¹⁹ *Id.*

²⁰ *Id.*

²¹ See Securities Exchange Act Release No. 36841 (February 14, 1996), 61 FR 6666 (February 21, 1996) (SR-CBOE-95-43) (SR-PSE-95-24) (Order Approving Proposed Rule Changes and Notice of Filing and Order Granting Accelerated Approval of Amendments by the Chicago Board Options Exchange, Inc. and the Pacific Stock Exchange, Inc., Relating to the Listing of Flexible Exchange Options on Specified Equity Securities).

²² *Id.* The Exchange notes that the Commission found pursuant to Rule 9b-1 under the Act, that FLEX Options, including FLEX Equity Options, are standardized options for purposes of the options disclosure framework established under Rule 9b-1 of the Act. *Id.*

Arca”), Nasdaq PHLX LLC (“Phlx”), and FLEX Equity Options on BOX Exchange LLC (“BOX”).²³ The Exchange further notes that Cboe offers electronic and open outcry FLEX Options trading while NYSE American, NYSE Arca, Phlx and BOX offer only open outcry trading of FLEX Options on their respective trading floors.²⁴ The Exchange now proposes to allow for the trading of FLEX Options on its electronic market²⁵ in a substantially similar manner as Cboe’s electronic FLEX Options, with certain intended differences primarily to align to current System behavior (and especially current auction behavior) to provide increased consistency for Members trading FLEX Options and non-FLEX Options on ISE, as discussed in detail below. Further, the Exchange has omitted certain Cboe rules from the proposed rules due to differences in scope and operation of FLEX trading at Cboe compared to the proposed scope and operation of FLEX trading on ISE, each as noted below. For example, the Exchange will not include Cboe rule provisions related to open outcry trading, Asian- or Cliquet-settled FLEX index options, or FLEX index options with an index multiplier of one (“Micro FLEX Index Options”) as it does not offer these capabilities today. For the same reason, the Exchange will not allow prices in FLEX trading to be expressed as percentages under this proposal. The Exchange also will not incorporate the concept of a “FLEX Official” as this is a floor concept and the Exchange does not have a trading floor. As such, instead of nullifying FLEX Option transactions that do not conform to the terms of the Exchange’s proposed FLEX rules,²⁶ the Exchange will System enforce its proposed FLEX rules and reject at the outset a FLEX Option transaction that does not conform to the terms of the proposed

²³ See Cboe Rules 4.20–4.22 and 5.70–5.75, NYSE American Rules 900G–910G, NYSE Arca Rules 5.30–O–5.41–O, Phlx Options 8, Section 34, and BOX Rules 5055 and 7605. The Exchange also notes that BOX recently received approval from the Commission to allow for the trading of FLEX equity options on the BOX trading floor. See Securities Exchange Act Release No. 100156 (May 15, 2024), 89 FR 44721 (May 21, 2024) (SR–BOX–2023–20).

²⁴ See *supra* note 23.

²⁵ The Exchange is not proposing to add open outcry FLEX Options trading as it does not have a trading floor.

²⁶ Cboe Rule 5.75(b) sets forth the responsibilities of FLEX Officials, including the responsibility to nullify certain FLEX Option transactions that do not conform to Cboe’s FLEX rules, and to call upon a FLEX Market-Maker with an appointment in a FLEX Option class to respond to open outcry FLEX Auctions in that FLEX Option class when no other ICMPs respond. The Exchange will not adopt these provisions because a FLEX Official is a floor concept and Exchange does not have a trading floor (and therefore no open outcry auctions).

FLEX rules. The very few instances where the Exchange will not System-enforce the proposed FLEX rules and will instead apply its surveillance patterns will be specifically noted below.

Proposal

Transactions in FLEX Options traded on the Exchange will generally be subject to the same rules that apply to the trading of equity options and index options. In order, however, to provide investors with the flexibility to designate certain of the terms of the options, and to accommodate other special features of FLEX Options and the way in which they are traded, the Exchange proposes new rules applicable to FLEX Options in new Options 3A, Sections 1–19.

A. General Provisions (Section 1)

Proposed Section 1(a) will set forth the applicability of Exchange Rules, and will provide that Options 3A Rules will apply only to FLEX Options and that trading of FLEX Options will be subject to all other Rules applicable to the trading of options on the Exchange, unless otherwise provided in Options 3A. The Exchange has conducted a thorough review of its existing trading rules to ensure that the proposed Rules in Options 3A accurately reflects the application of the Exchange’s non-FLEX Option trading rules to FLEX Options,²⁷ as well as those non-FLEX Option trading rules that would not apply to FLEX Options.²⁸

²⁷ For example, Options 3, Section 1 (Hours of Business) will apply to FLEX and non-FLEX Options, except the Exchange may determine to narrow or otherwise restrict the trading hours for FLEX Options. See proposed Options 3A, Section 2. As another example, Options 3, Section 9 (Trading Halts) will apply to FLEX and non-FLEX Options. The Exchange notes that pursuant to proposed Options 3A, Section 9, it will always halt trading in a FLEX Option class when trading in a non-FLEX Option class with the same underlying equity security or index is halted on the Exchange. Furthermore, the System does not accept a FLEX Order for a FLEX Option series while trading in a FLEX Option class is halted.

²⁸ For example, the Exchange’s simple and complex order books will not be available for transactions in FLEX Options. See proposed Options 3A, Section 10. In addition, FLEX Options may not trade via the Block Order Mechanism (Options 3, Section 11(a)), simple and complex Facilitation Mechanism (Options 3, Section 11(b) and (c)), or as simple and complex Customer Cross Orders (Options 3, Section 12(a) and (b)), simple and complex Qualified Contingent Cross (“QCC”) Orders (Options 3, Section 12(c) and (d)), and simple and complex QCC with Stock Orders (Options 3, Section 12(e) and (f)). If the Exchange intends to allow FLEX Options to trade via any of the foregoing auction mechanisms or as any of the foregoing crossing orders, the Exchange would be required to file a proposed rule change with the Commission to amend its FLEX rules to allow for the use of the foregoing trading functionality for FLEX Options.

Proposed Section 1(b) will set forth the definitions used specifically in Options 3A, namely that the term “FLEX Option” means a flexible exchange option. A FLEX Option on an equity security may be referred to as a “FLEX Equity Option,” and a FLEX Option on an index may be referred to as a “FLEX Index Option.” Further, the term “FLEX Order” means an order submitted in a FLEX Option pursuant to Options 3A.

The Exchange also proposes to add the definition of “FLEX Order” in Options 3, Section 7 (Order Types) in new paragraph (z). While FLEX Orders will also be defined in (and governed by) Options 3A, the Exchange believes that it will be useful to market participants to have the order types available on ISE centralized within one rule. Lastly, the Exchange proposes a non-substantive change to paragraph (y) in Options 3, Section 7 to fix a typo.

B. Hours of Business (Section 2)

Proposed Section 2(a) will provide that the trading hours for FLEX Options will be the same as the trading hours for corresponding non-FLEX Options as set forth in Options 3, Section 1, except the Exchange may determine to narrow or otherwise restrict the trading hours for FLEX Options.²⁹ Therefore, the trading hours for FLEX Options will generally be 9:30 a.m. to 4:00 p.m. Eastern time, except for certain options products that trade until 4:15 p.m. Eastern time.³⁰ This would align the proposed trading hours for FLEX Options with the current trading hours for corresponding non-FLEX Options.

As it relates to the Exchange’s proposed discretion relating to the trading hours for FLEX Options, this is consistent with Cboe’s FLEX Options rules as noted above. The Exchange believes that given the unique nature of FLEX, in contrast to the non-FLEX market, it is reasonable to permit the Exchange, in its discretion, to narrow or otherwise restrict the trading hours for FLEX Options, so long as such trading hours occur within the normal options trading hours of the Exchange described above. The Exchange would provide adequate advance notification to its Members of such changes in FLEX trading hours.

²⁹ See Cboe Rule 5.1(b)(3)(A) for materially identical provisions.

³⁰ See Options 3, Section 1(c)–(e). These products are currently options on Exchange-Traded Fund Shares (as defined in Options 4, Section 3(h)), options on Index-Linked Securities (as defined in Options 4, Section 3(k)(1)), and options on certain broad-based indexes, as designated by the Exchange.

C. FLEX Option Classes and Permissible Series (Section 3(a) and (b))

Pursuant to proposed Section 3(a), the Exchange may authorize for trading a FLEX Option class on any equity security (except the iShares Bitcoin Trust ETF) or index if it may authorize for trading a non-FLEX Option class on that equity security or index pursuant to Options 4, Section 3 and Options 4A, Section 3,³¹ respectively, even if the Exchange does not list that non-FLEX Option class for trading.³² The Exchange proposes to exclude iShares Bitcoin Trust ETF (“IBIT”) from being eligible for trading as a FLEX Option on ISE to be consistent with the Commission’s approval of IBIT options, which required the position limit for IBIT options to be 25,000 contracts.³³ As discussed in the position limits section below, there will generally be no position limits for FLEX Equity Options.³⁴ The Exchange therefore proposes to exclude IBIT options from being eligible to trade as a FLEX Option (namely, a FLEX ETF option) to continue to limit the position limits for IBIT options. For clarity, this exclusion will apply to both physically-settled and cash-settled FLEX ETF options (as further described in this filing), such that IBIT options will be excluded from being eligible to trade as a physically-settled or a cash-settled FLEX ETF option. If the Exchange determines to allow FLEX trading on IBIT options at a later date, it will do so by submitting a 19b-4 rule filing with the Commission.

Proposed Section 3(b) will provide that the Exchange may approve a FLEX Option series for trading in any FLEX Option class it may authorize for trading pursuant to proposed Section 3(a). FLEX Option series are not pre-established. A FLEX Option series is eligible for trading on the Exchange upon submission to the System of a FLEX Order for that series pursuant to proposed Sections 11 through 13,³⁵

³¹ Options 4, Section 3 provides the criteria for the listing of options on several different underlying types of securities, including, for example, securities registered with the SEC under Regulation NMS of the Act (“NMS stock”) and exchange-traded funds (“ETFs”). Options 4A, Section 3 provides the criteria for the listing of options on indexes.

³² See Cboe Rule 4.20 for materially identical provisions.

³³ See Securities Exchange Act Release No. 101128 (September 20, 2024), 89 FR 78942 (September 26, 2024) (SR-ISE-2024-03).

³⁴ See proposed Options 3A, Section 18(b)(1)(A).

³⁵ Proposed Sections 11 through 13 of Options 3A will govern the electronic FLEX Auction, FLEX PIM, and FLEX SOM, respectively. As discussed later in this filing, FLEX Orders may only be submitted through an electronic FLEX Auction, FLEX PIM, or FLEX SOM.

subject to the following stipulations.³⁶ First, the Exchange will only permit trading in a put or call FLEX Option series that does not have the same exercise style, same expiration date, and same exercise price as a non-FLEX Option series on the same underlying security or index that is already available for trading. This would include permitting trading in a FLEX Option series before a series with identical terms is listed for trading as a non-FLEX Option series. If the Exchange lists for trading a non-FLEX Option series with identical terms as a FLEX Option series, the FLEX Option series will become fungible with the non-FLEX Option series pursuant to proposed paragraph (d) of Section 3. The System would not accept a FLEX Order for a put or call FLEX Option series if a non-FLEX Option series on the same underlying security or index with the same expiration date, exercise price, and exercise style is already listed for trading.³⁷ Second, a FLEX Order for a FLEX Option series may be submitted on any trading day prior to the expiration date.³⁸ The Exchange also proposes to clarify in proposed Section 3(b)(2) that on the expiration date, a FLEX Order for the expiring FLEX Option series may only be submitted to close out a position in such expiring FLEX Option series.³⁹

Third, in the event the relevant expiration is a holiday pursuant to General 3 (which incorporates Nasdaq General 3, Rule 1030 by reference),⁴⁰ proposed Section 3(d) will apply to options with an expiration date that is the business day immediately preceding the holiday, except for Monday-expiring Weekly Expirations (as defined in Options 4A, Section 3), in which case proposed Section 3(d) will apply to options with an expiration date that is a business day immediately following the holiday.⁴¹

³⁶ See proposed Options 3A, Section 3(b), which is based on Cboe Rule 4.21(a).

³⁷ See proposed Options 3A, Section 3(b)(1), which is based on Cboe Rule 4.21(a)(1).

³⁸ See proposed Options 3A, Section 3(b)(2), which is based on Cboe Rule 4.21(a)(2). The Exchange notes that it will System enforce which options are eligible to be submitted as FLEX Options. As such, the System will reject at the outset a FLEX Option transaction that does not conform to the terms of the FLEX rules.

³⁹ The Exchange will System enforce this provision such that it will reject an opening position in an expiring FLEX Option series on the day of expiration.

⁴⁰ ISE General 3 incorporates by reference Series 1000 in General 3 of the Rules of The Nasdaq Stock Market, LLC (“Nasdaq”) (including Nasdaq Rule 1030).

⁴¹ See proposed Options 3A, Section 3(b)(3), which is based on Cboe Rule 4.22(c).

D. FLEX Options Terms (Section 3(c))

Proposed Section 3(c) will specify the terms that must be included in a FLEX Order.⁴² Specifically, when submitting a FLEX Order for a FLEX Option series to the System, the submitting Member must include one of each of the terms detailed in proposed subparagraphs (1)–(6) of Section 3(c) in the FLEX Order (all other terms of a FLEX Option series are the same as those that apply to non-FLEX Options), provided that a FLEX Equity Option overlying an ETF (cash- or physically-settled) may not be the same type (put or call) and may not have the same exercise style, expiration date, and exercise price as a non-FLEX Equity Option overlying the same ETF,⁴³ which terms constitute the FLEX Option series.

As proposed, the submitting Member must specify the following terms in the FLEX Order: (1) underlying equity security or index, as applicable (the index multiplier for FLEX Index Options is 100);⁴⁴ (2) type of option (*i.e.*, put or call);⁴⁵ (3) exercise style, which may be American-style or European-style;⁴⁶ (4) expiration date, which may be any business day (specified to the day, month, and year) no more than 15 years from the date on which a Member submits a FLEX Order to the System;⁴⁷ (5) settlement type for the FLEX Equity Option or FLEX Index Option, as applicable;⁴⁸ and (6) exercise

⁴² See Cboe Rule 4.21(b) for similar provisions. The Exchange notes that unlike Cboe, it is not proposing FLEX Index Options with a multiplier of 1 (*i.e.*, Micro FLEX Index Options) or FLEX Index Options that are Asian- or Cliquet-settled as the Exchange does not have these capabilities today for index options. For the same reason, the Exchange is not proposing to allow exercise prices to be expressed as a percentage value. Therefore, the Exchange has not incorporated the applicable provisions in this Rule.

⁴³ The Exchange will discuss cash-settled FLEX Equity Options overlying an ETF (“cash-settled FLEX ETFs”) later in this filing. As discussed below, the Commission previously approved a rule filing by NYSE American to permit the listing and trading of this product, and Cboe recently filed an immediately effective rule change based on NYSE American’s filing. See *infra* notes 243 and 244.

⁴⁴ See proposed Options 3A, Section 3(c)(1), which is based on Cboe Rule 4.21(b)(1) except for the provisions relating to Micro FLEX Index Options.

⁴⁵ See proposed Options 3A, Section 3(c)(2), which is based on Cboe Rule 4.21(b)(2) except the provisions related to Asian-settled or Cliquet-settled FLEX Index Options.

⁴⁶ See proposed Options 3A, Section 3(c)(3), which is based on Cboe Rule 4.21(b)(3) except with respect to Asian-settled or Cliquet-settled FLEX Index Options.

⁴⁷ See proposed Options 3A, Section 3(c)(4), which is based on Cboe Rule 4.21(b)(4) except with respect to Asian-settled or Cliquet-settled FLEX Index Options.

⁴⁸ See proposed Options 3A, Section 3(c)(5), which is based on Cboe Rule 4.21(b)(5) except with

price, which may be in increments no smaller than \$0.01.⁴⁹ Further, the Exchange may determine the smallest increment for exercise prices of FLEX Options on a class-by-class basis without going lower than \$0.01.⁵⁰ The Exchange notes that the exercise price of the FLEX Option would generally be dependent on the price of the underlying security.

As it relates to the settlement type for FLEX Equity Options, the Exchange proposes in subparagraph (c)(5)(A)(i) of Options 3A, Section 3 that FLEX Equity Options, other than as permitted in proposed subparagraphs (c)(5)(A)(ii) and (iii), are settled with physical delivery of the underlying security. Proposed subparagraph (c)(5)(A)(ii) will allow for the cash-settlement of certain qualifying FLEX Equity Options with an underlying security that is an ETF.⁵¹ Proposed subparagraph (c)(5)(A)(iii) will provide that FLEX Equity Options are subject to the exercise by exception provisions of OCC Rule 805.

As it relates to the settlement type for FLEX Index Options, the Exchange proposes in subparagraphs (c)(5)(B)(i) and (ii) of Options 3A, Section 3 that FLEX Index Options are settled in U.S. dollars, and may be either a.m.-settled (with exercise settlement value determined by reference to the reported level of the index derived from the reported opening prices of the component securities) or p.m.-settled (with exercise settlement value determined by reference to the reported level of the index derived from the reported closing prices of the component securities). The Exchange notes that Cboe recently received approval of its pilot program that permitted it to list p.m.-settled FLEX Index Options whose exercise settlement value is derived from closing prices on the last trading day prior to expiration that expire on or within two business days of a third Friday-of-the-

respect to Asian-settled or Cliquet-settled FLEX Index Options.

⁴⁹ See proposed Options 3A, Section 3(c)(6), which is based on Cboe Rule 4.21(b)(6) except the Exchange is not proposing Cliquet-settled Index Options or to allow exercise prices to be expressed as a percentage value.

⁵⁰ See proposed Options 3A, Section 3(c), which is based on Cboe Rule 4.21(b) except for the provisions allowing the exercise price to be expressed as a percentage amount and with respect to Micro FLEX Index Options. As noted above, the Exchange does not offer these capabilities today for non-FLEX index options. The Exchange will also clarify that it would not go lower than \$0.01 when determining the smallest increment for exercise prices of FLEX Options to make clear that it would stay within the stated confines of this Rule.

⁵¹ As discussed later in this filing, the Exchange is proposing to list and trade cash-settled FLEX ETFs in the same manner as NYSE American and Cboe.

month expiration day for a non-FLEX Option (“FLEX PM Third Friday Options”).⁵² Consistent with the Commission’s approval of Cboe’s proposal, the Exchange is proposing to allow the listing of FLEX PM Third Friday Options on ISE as well, and will align proposed Section 3(c)(5)(B)(ii) with Cboe Rule 4.21(b)(5)(B)(ii).⁵³

E. FLEX Fungibility (Section 3(d))

Proposed Section 3(d)(1)(A) will provide that if the Exchange lists for trading a non-FLEX Option series with identical terms as a FLEX Option series, all existing open positions established under the FLEX trading procedures will become fully fungible with transactions in the identical non-FLEX Option series.⁵⁴ In addition, proposed Section 3(d)(1)(B) will provide that any further trading in the series would be as non-FLEX Options subject to non-FLEX trading procedures and Rules.⁵⁵ The foregoing provisions are materially identical to Cboe Rule 4.22(a)(1) and (2).

Notwithstanding the above, if a non-FLEX Option series⁵⁶ is added intraday,

⁵² See Securities Exchange Act Release No. 99222 (December 21, 2023), 88 FR 89771 (December 28, 2023) (SR-CBOE-2023-018) (“FLEX Settlement Pilot Approval”). In support of making the pilot a permanent program, Cboe cited to its own review of pilot data during the course of the pilot program and a study by the Commission’s Division of Economic and Risk Analysis (“DERA”) staff. See FLEX Settlement Pilot Approval, notes 18 and 35.

⁵³ The only broad-based index option that would be able to list as a FLEX PM Third Friday Option is the Nasdaq-100 Index option (“NDX” or “NDX options”) because the Exchange only received approval to list a third-Friday-of-the-month p.m. expiration on NDX options its standardized market. See Securities Exchange Act Release No. 98935 (November 14, 2023), 88 FR 80792 (November 20, 2023) (SR-ISE-2023-20) (Order Approving a Proposed Rule Change To Permit the Listing and Trading of P.M.-Settled Nasdaq-100 Index Options With a Third-Friday-of-the-Month Expiration).

⁵⁴ An open position resulting from a transaction on the Exchange becomes fungible post-trade and is separate from the execution occurring on the Exchange. For example, assume a Member buys one (1) American style AAPL call option expiring on October 9, 2024, with a strike price of 150, which is a FLEX series because there is no standard option listed with those same terms. Now assume, while holding this position, a standard option with the same terms is listed (American style AAPL call option expiring on October 9, 2024, with a strike price of 150). After this standard option is listed, the Member purchases one (1) contract in this non-FLEX option series. After this second transaction, the Participant will have an open position of two (2) contracts in the standard AAPL call expiring on October 9, 2024, with a 150 strike price.

⁵⁵ This includes all priority and trade-through provisions on the Exchange. See, e.g., Options 3, Section 10 and Options 5, Section 2.

⁵⁶ Cboe Rule 4.22(b)(1) currently indicates that Cboe’s closing-only provisions apply if a non-FLEX Option *American-style* series is added intraday. The Exchange, however, believes it is more straightforward to apply the closing-only provisions to *all* non-FLEX Option series (*i.e.*, American-style and European-style FLEX Option series) instead of limiting these provisions to one type of exercise

for the balance of that trading day, a position established under the FLEX trading procedures may be closed using the FLEX trading procedures in this Options 3A against another closing only FLEX position. No FLEX Orders may be submitted into an electronic auction pursuant to Sections 11(b), 12, or 13 below for a FLEX Option series with the same terms as the non-FLEX Option series, unless the FLEX Order is a closing order, and it is the day on which the non-FLEX Option series was added intraday. Members may only submit responses that close out existing FLEX positions.⁵⁷ In the event the non-FLEX Option series is added on a trading day after the position is established, the holder or writer of a FLEX Option position established under the FLEX trading procedures would be permitted to close such position as a non-FLEX transaction consistent with the requirements of subsection (d)(1) of this rule.⁵⁸ The Exchange will notify Members when a FLEX Option series is restricted to closing only transactions. The System will reject a transaction in such a restricted series that does not conform to the requirements specified in proposed Options 3A, Section 3(d).⁵⁹

F. Units of Trading; Minimum Trading Increments (Sections 4 and 5)

Proposed Section 4(a) of Options 3A will provide that bids and offers for

style. As such, the Exchange’s proposed language in Options 3A, Section 3(d)(2)(A) will instead provide that the Exchange’s closing-only provisions would apply “if a non-FLEX Option is added intraday.” See BOX Rule 7605(d)(3), which similarly does not limit BOX’s closing-only provisions to American-style FLEX Options series.

⁵⁷ See proposed Options 3A, Section 3(d)(2)(A), which is based on Cboe Rule 4.22(b)(1) except the Exchange is not incorporating Cboe’s provisions for open outcry trading as the Exchange does not offer open outcry trading today. The Exchange is also adding cross-cites to its electronic FLEX SOM and FLEX PIM auctions in proposed Options 3A, Sections 12 and 13 because the closing only provisions in proposed Options 3A, Section 3(d)(2) will also apply to those electronic FLEX auctions. Lastly, the Exchange notes that unlike Cboe, it is not proposing to add FLEX Index Options with a multiplier of 1 (*i.e.*, Micro FLEX Index Options) and will therefore not incorporate Cboe’s closing only language with respect to Micro FLEX Index Options in Rule 4.22(b)(2).

⁵⁸ See proposed Options 3A, Section 3(d)(2)(B), which is materially identical to BOX Rule 5055(f)(3). The Exchange is adding this language to clarify how it would handle open FLEX positions if an identical non-FLEX Option series is added on the day after.

⁵⁹ See proposed Options 3A, Section 3(d)(2), which is based on Cboe Rule 4.22(b), except the Exchange is replacing the concept of “FLEX Official” from Cboe’s rule to “the System” as a FLEX Official is a floor concept. As such, the Exchange will System enforce the rejection of FLEX Options that are fully fungible with a non-FLEX Option instead of following Cboe, which specifies that a FLEX Official could nullify such a transaction on Cboe.

FLEX Options must be expressed in U.S. dollars and decimals in the minimum increments as set forth in proposed Section 5.⁶⁰ Proposed Section 5(a) will provide that the Exchange would determine the minimum increment for bids and offers on FLEX Options on a class-by-class basis, which may not be smaller than \$0.01 for the options leg of a FLEX Option.⁶¹ Proposed Section 5(b) will provide that for the stock leg of a FLEX Option, the minimum increments are set forth in Options 3A, Section 11(b)(1)(G), Section 12(a)(5), and Section 13(a)(5). As discussed later in this filing, the foregoing rules specify how minimum increments for complex FLEX Orders (including complex FLEX Orders with a stock component) would be handled. The Exchange is adding these cross cites in the minimum increments rule in proposed Options 3A, Section 5(b) for transparency and clarity.

G. Types of Orders; Order and Quote Protocols (Section 6)

Pursuant to proposed Section 6(a), the Exchange may determine to make only the Limit Order and Cancel and Replace Order order types⁶² and Immediate or Cancel times-in-force,⁶³ respectively, in Options 3, Section 7 available on a class or System basis for FLEX Orders.⁶⁴ The Exchange notes that it currently has the authority to make certain order types and TIFs available on a class or System basis for non-FLEX Options pursuant to Options 3, Section 7, and therefore proposes to have similar authority with respect to FLEX Options.

Proposed Section 6(b) will provide that only the following order and quote protocols in Supplementary Material .03 to Options 3, Section 7 will be available for FLEX Orders, FLEX auction

notifications, and FLEX auction responses:⁶⁵

- FIX:⁶⁶ FLEX Orders and FLEX auction responses
- OTTO:⁶⁷ FLEX Orders, FLEX auction notifications, and FLEX auction responses
- SQF:⁶⁸ FLEX auction notifications and FLEX auction responses

H. Complex Orders (Section 7)

Pursuant to proposed Section 7(a), the Exchange may make complex orders, including a Complex Options Order,⁶⁹

⁶⁵ Notes 58–60 below describe what features are available on these protocols today for non-FLEX Options. The Exchange is proposing to specify that some of these features (*i.e.*, sending/receiving FLEX Orders, FLEX notifications and FLEX responses) will be available for FLEX Options through the specified protocols as described above. While other basic features will be available for FLEX Options (for example, the options symbol directory will be available for FLEX Options), the Exchange is proposing to specify the particular features in proposed Options 3A, Section 6(b) to highlight the most important features that would be available through these protocols for FLEX trading.

⁶⁶ “Financial Information eXchange” or “FIX” is an interface that allows Members and their Sponsored Customers to connect, send, and receive messages related to orders and auction orders to the Exchange. Features include the following: (1) execution messages; (2) order messages; (3) risk protection triggers and cancel notifications; and (4) post trade allocation messages. See Supplementary Material .03(a) to Options 3, Section 7.

⁶⁷ “Ouch to Trade Options” or “OTTO” is an interface that allows Members and their Sponsored Customers to connect, send, and receive messages related to orders, auction orders, and auction responses to the Exchange. Features include the following: (1) options symbol directory messages (*e.g.*, underlying and complex instruments); (2) System event messages (*e.g.*, start of trading hours messages and start of opening); (3) trading action messages (*e.g.*, halts and resumes); (4) execution messages; (5) order messages; (6) risk protection triggers and cancel notifications; (7) auction notifications; (8) auction responses; and (9) post trade allocation messages. See Supplementary Material .03(b) to Options 3, Section 7.

⁶⁸ “Specialized Quote Feed” or “SQF” is an interface that allows Market Makers to connect, send, and receive messages related to quotes, Immediate-or-Cancel Orders, and auction responses to the Exchange. Features include the following: (1) options symbol directory messages (*e.g.*, underlying and complex instruments); (2) System event messages (*e.g.*, start of trading hours messages and start of opening); (3) trading action messages (*e.g.*, halts and resumes); (4) execution messages; (5) quote messages; (6) Immediate-or-Cancel Order messages; (7) risk protection triggers and purge notifications; (8) opening imbalance messages; (9) auction notifications; and (10) auction responses. The SQF Purge Interface only receives and notifies of purge requests from the Market Maker. Market Makers may only enter interest into SQF in their assigned options series. See Supplementary Material .03(c) to Options 3, Section 7.

⁶⁹ A Complex Options Order is an order for a Complex Options Strategy, which is the simultaneous purchase and/or sale of two or more different options series in the same underlying security, for the same account, in a ratio that is equal to or greater than one-to-three (.333) and less than or equal to three-to-one (3.00) and for the purpose of executing a particular investment strategy. See Options 3, Section 14(a)(1).

Stock-Options Order,⁷⁰ and Stock-Complex Order⁷¹ available for FLEX trading. Complex FLEX Orders may have up to the maximum number of legs determined by the Exchange.⁷² Each leg of a complex FLEX Order: (1) must be for a FLEX Option series authorized for FLEX trading with the same underlying equity security or index; (2) must have the same exercise style (American or European); and (3) for a FLEX Index Option, may have a different settlement type (a.m.-settled or p.m.-settled).⁷³ The Exchange notes that a non-FLEX complex order can have both am-settled and p.m.-settled legs today. The Exchange received approval to permit the listing and trading of p.m.-settled NDX options pursuant to Supplementary Material .07 to Options 4A, Section 12.⁷⁴ Specifically, the Exchange is permitted to list p.m.-settled NDX options that expire (1) on any Monday, Tuesday, Wednesday, Thursday, or Friday (other than the third Friday-of-the-month or days that coincide with an end-of-month expiration)⁷⁵ or (2) on the last day of the

⁷⁰ A Stock-Option Order is an order for a Stock-Option Strategy, which is the purchase or sale of a stated number of units of an underlying stock or a security convertible into the underlying stock (“convertible security”) coupled with the purchase or sale of options contract(s) on the opposite side of the market representing either (A) the same number of units of the underlying stock or convertible security, or (B) the number of units of the underlying stock necessary to create a delta neutral position, but in no case in a ratio greater than eight-to-one (8.00), where the ratio represents the total number of units of the underlying stock or convertible security in the option leg to the total number of units of the underlying stock or convertible security in the stock leg. See Options 3, Section 14(a)(2).

⁷¹ A Stock-Complex Order is an order for a Stock-Complex Strategy, which is the purchase or sale of a stated number of units of an underlying stock or a security convertible into the underlying stock (“convertible security”) coupled with the purchase or sale of a Complex Options Strategy on the opposite side of the market representing either (A) the same number of units of the underlying stock or convertible security, or (B) the number of units of the underlying stock necessary to create a delta neutral position, but in no case in a ratio greater than eight-to-one (8.00), where the ratio represents the total number of units of the underlying stock or convertible security in the option legs to the total number of units of the underlying stock or convertible security in the stock leg. See Options 3, Section 14(a)(3).

⁷² The Exchange will initially permit a maximum of 10 legs.

⁷³ See Cboe Rule 5.70(b) for similar provisions except the Exchange is not proposing Asian-settled or Cliquet-settled FLEX Index Options, as currently specified in Cboe Rule 5.70(b)(3).

⁷⁴ See Securities Exchange Act Release No. 98450 (September 20, 2023), 88 FR 66111 (September 26, 2023) (SR–ISE–2023–08) (Order Granting Approval of a Proposed Rule Change, as Modified by Amendment No. 1, To Make Permanent Certain P.M.-Settled Pilots).

⁷⁵ See Supplementary Material .07(a) to Options 4A, Section 12.

⁶⁰ See Cboe Rule 5.3(e)(3) for similar provisions, except the Exchange is not proposing to allow prices to be expressed as a percentage value, or to provide for Micro FLEX Index Options.

⁶¹ See Cboe Rule 5.4(c)(4) for similar provisions, except the Exchange is not proposing to allow prices to be expressed as a percentage value. The Exchange is also clarifying that this provision would apply to the options leg of a FLEX Option.

⁶² See Options 3, Sections 7(b) and 7(f) for a description of Limit Orders and Cancel and Replace Orders, respectively. All of the other order types listed in Options 3, Section 7 (such as Customer Cross Orders, Qualified Contingent Cross Orders, QCC with Stock Orders, Block Orders, and Facilitation Orders) do not apply to FLEX.

⁶³ See Supplementary Material .02(d) to Options 3, Section 7 for a description of Immediate-or-Cancel. All of the other TIFs in Supplementary Material .02 to Options 3, Section 7 will not apply to FLEX.

⁶⁴ See Options 3, Section 7 for descriptions of these order types and times-in-force.

trading month.⁷⁶ In addition, NDX options are also currently allowed to be listed as a.m.-settled with a standard expiration (*i.e.*, the third-Friday-of-the-month).⁷⁷ Therefore, ISE may currently list NDX options that are both a.m.-settled and p.m.-settled for its non-FLEX market. As such, the Exchange's FLEX proposal for complex orders in this respect will not only align with Cboe's current FLEX complex order functionality as noted above,⁷⁸ but will also align with its own current non-FLEX complex order functionality.

Pursuant to proposed Section 7(b), complex FLEX Orders will not have to adhere to the ratio requirements in Options 3, Sections 14(a)(1)–(3). Options 3, Sections 14(a)(1)–(3) currently includes the complex ratio requirements for Complex Options Strategies, Stock-Options Strategies, and Stock-Complex Strategies.⁷⁹ The Exchange is not changing the complex ratio requirements for non-FLEX complex orders under this proposal. Instead, it is proposing to offer this feature only for complex FLEX Orders so that Members may submit complex FLEX Orders with any ratio.⁸⁰ The Exchange notes that Cboe currently permits complex FLEX Orders to be submitted with any ratio.⁸¹

I. Opening of FLEX Trading (Section 8)

Proposed Section 8(a) will specify that there will be no Opening Process⁸²

⁷⁶ See Supplementary Material .07(b) to Options 4A, Section 12.

⁷⁷ See Options 4A, Section 12(a)(5).

⁷⁸ See *supra* note 73.

⁷⁹ See *supra* notes 69–71.

⁸⁰ For instance, the Exchange may permit Complex Options Strategies with a ratio on the options legs less than one-to-three (.333) or greater than three-to-one (3.00), and Stock-Option Strategies with a ratio greater than eight-to-one (8.00), where the ratio represents the total number of units of the underlying stock or convertible security in the option leg(s) to the total number of units of the underlying stock or convertible security in the stock leg.

⁸¹ See Cboe US Options Complex Book Process, Section 2.1 (Ratios) and Section 3 (Complex FLEX Order Functionality), available at <https://cdn.cboe.com/resources/membership/US-Options-Complex-Book-Process.pdf>. For its non-FLEX market, the Exchange will continue to require non-FLEX complex orders to adhere to the complex ratios in Options 3, Sections 14(a)(1)–(3), and therefore will not permit non-FLEX complex orders to be submitted in any ratio outside of those stipulated in Section 14.

⁸² As described in Options 3, Section 8(c)(i), ISE's "Opening Process" for an option series is conducted pursuant to Options 3, Section 8 paragraphs (f)–(j), on or after 9:30 a.m. Eastern Time if the Away Best Bid or Offer, if any, is not crossed and the System has received, within two minutes of the opening trade or quote on the market for the underlying security, a Valid Width Quote. The System will accept a Primary Market Maker's Valid Width Quote or the Valid Width Quote of at least one Competitive Market Maker. The term "Away

pursuant to Options 3, Section 8 in FLEX Options. Instead, as specified in proposed Section 8(b), Members may begin submitting FLEX Orders into an electronic FLEX Auction pursuant to proposed Section 11(b), a FLEX PIM pursuant to proposed Section 12, or a FLEX SOM pursuant to proposed Section 13 when the underlying security is open for trading.⁸³ The Exchange will also make clear in proposed Section 8(b) that for FLEX Index Options, the term "underlying security" will have the same meaning as defined in Options 4A, Section 2(q).⁸⁴

Because market participants incorporate transaction prices of underlying securities or the values of underlying indexes when pricing options (including FLEX Options), the Exchange believes that it will benefit investors for FLEX Options trading to not be available until that information has begun to be disseminated in the market (*i.e.*, when the security opens for trading).

Additionally, the Exchange's Opening Process is used to open or reopen a series of options on ISE at a single opening price.⁸⁵ There is a period of time before an options series opens during which orders placed on the Exchange's order book do not generate trade executions but may participate in the Opening Process.⁸⁶ As noted above, FLEX Options will not be placed on the Exchange's simple and complex order books and therefore will not have an Opening Process.⁸⁷ FLEX Options are created with terms unique to individual investment objectives. As such, each investor may require FLEX Options with slightly different terms than those already created. These individually defined FLEX Options are customized for each investor, so the Opening Process may not be useful for investors who may create their own FLEX Options because the Opening Process is designed, in part, to determine a single opening, or reopening, price based on

Best Bid or Offer" or "ABBO" means the displayed National Best Bid or Offer not including the Exchange's Best Bid or Offer. See Options 1, Section 1(a)(4).

⁸³ See proposed Options 3A, Section 8(a) and (b), which is based on Cboe Rule 5.71 except with respect to open outcry trading and trading sessions outside of regular trading hours.

⁸⁴ Options 4A, Section 2(q) states that the term "underlying security" or "underlying securities" with respect to an index options contract means any of the securities that are the basis for the calculation of the index.

⁸⁵ See Options 3, Section 8(h) and (j).

⁸⁶ See Options 3, Section 8(c).

⁸⁷ See proposed Options 3A, Section 10(a). Instead, Members will be required to submit FLEX Orders into an electronic FLEX Auction, FLEX PIM, or FLEX SOM. See proposed Options 3A, Section 11(a).

orders and quotes from multiple Members. With the bespoke nature of FLEX Options, there is not the opportunity, nor the need, to bring together multiple orders and quotes as part of an Opening Process.

J. Trading Halts (Section 9)

Proposed Section 9 will provide that the Exchange may halt trading in a FLEX Option class pursuant to Options 3, Section 9, and always halts trading in a FLEX Option class when trading in a non-FLEX Options class with the same underlying equity security or index is halted on the Exchange. The System will not accept a FLEX Order for a FLEX Option series while trading in a FLEX Option class is halted.⁸⁸

K. Exchange Order Books (Section 10)

Proposed Section 10 will provide that the Exchange's simple and complex order books will not be available for transactions in FLEX Options. Accordingly, FLEX Options may only be traded on the Exchange by submitting FLEX Orders into a FLEX Electronic Auction pursuant to proposed Options 11(b), FLEX PIM pursuant to proposed Options 12, and FLEX SOM pursuant to proposed Options 13, each as discussed further below. The Exchange notes that its proposal is in line with other options exchanges' FLEX rules that do not contemplate the interaction of their respective order books with FLEX transactions.⁸⁹

L. FLEX Options Trading (Section 11)

Proposed Section 11 will describe the procedures for FLEX trading on the Exchange. Specifically, a FLEX Option series will only be eligible for trading if a Member submits a FLEX Order for that series into an electronic FLEX Auction pursuant to proposed paragraph (b) of Options 11, or submits the FLEX Order to a FLEX PIM or FLEX SOM Auction pursuant to proposed Section 12 or Section 13, respectively.⁹⁰

Proposed Section 11(a)(1) and (2) will specify the requirements for both simple and complex FLEX Orders.

- For a simple FLEX Order, a FLEX Order for a FLEX Option series submitted to the System must include all terms for a FLEX Option series set forth in proposed Section 3 as described

⁸⁸ See Cboe Rule 4.21(a)(3) for materially identical provisions.

⁸⁹ See *e.g.*, NYSE Arca Rule 5.30–O(c). See also Securities Exchange Act Release No. 87235 (October 4, 2019), 84 FR 54671 (October 10, 2019) (SR–CBOE–2019–084) (among other changes, eliminating the availability of an electronic book for FLEX Options).

⁹⁰ See proposed Options 3A, Section 11(a), which is based on Cboe Rule 5.72(b) except the Exchange is not proposing an open outcry FLEX Auction.

above, size, side of the market, and a bid or offer price.⁹¹ The Exchange also proposes that the System will not accept a FLEX Order with identical terms as a non-FLEX Option series that is already listed for trading to signify that this requirement is System-enforced.

- For a complex FLEX Order, a FLEX Order for a FLEX Option complex strategy submitted to the System must satisfy the criteria for a complex FLEX Order set forth in proposed Section 7(a) as described above, and include size, side of the market, and a net debit or credit price. Additionally, each leg of the FLEX Option complex strategy must include all terms for a FLEX Option series set forth in proposed Section 3.⁹² Similar to simple FLEX Orders, the Exchange proposes to System enforce the stipulation that it will not accept a FLEX Option complex strategy if a leg in the order has identical terms as a non-FLEX Option series that is already listed for trading.⁹³ The Exchange also proposes to add similar language as BOX to describe what would happen if there is a complex FLEX Order and subsequently, a non-FLEX Option series is introduced for the component leg(s). Specifically, proposed Section 11(a)(2)(A)(i) and (ii) will provide that if a non-FLEX Option series is added intra-day for a component leg(s) of a complex FLEX Order, the holder or writer of a FLEX Option position in the component leg(s) resulting from such complex FLEX Order would be permitted to close its position(s) under the FLEX trading procedures against another closing only FLEX Option position for the balance of the trading day on which the non-FLEX Option series is added. If a non-FLEX Option series is added for a component leg(s) of a complex FLEX Order on a trading day after the complex FLEX Order position is established, the holder or writer of a FLEX Option position in the component leg(s) resulting from such complex FLEX Order would be required to execute separate FLEX Option and non-FLEX Option transactions to close its position(s), such that FLEX Option component leg(s) would trade under the

⁹¹ See Cboe Rule 5.72(b)(1) for similar provisions. The Exchange does not have an analogous rule as Cboe Rule 5.7, which specifies the different trading sessions during which the system is available to receive FLEX orders, and thus has not incorporated the applicable language. As noted above, the Exchange will accept FLEX Orders entered into an electronic FLEX Auction, FLEX PIM or FLEX SOM when the underlying security is open for trading. See proposed Options 3A, Section 8.

⁹² See Cboe Rule 5.72(b)(2) for similar provisions. As noted above for simple FLEX Orders, the Exchange does not have an analogous rule as Cboe Rule 5.7, and thus has not incorporated the applicable language. See *supra* note 91.

⁹³ See proposed Options 3A, Section 11(a)(2)(A).

FLEX trading procedures and non-FLEX Option component leg(s) would trade subject to the non-FLEX trading procedures and rules.⁹⁴ Additionally, a complex FLEX Order submitted into the System for an electronic FLEX Auction pursuant to proposed Section 11(b), a FLEX PIM pursuant to Section 12, or a FLEX SOM pursuant to Section 13 must include a bid or offer price for each leg, which leg prices when combined must equal the net price of the complex FLEX Order.⁹⁵

Proposed Section 11(b) will describe the electronic FLEX Auction. The proposed FLEX Auction will be substantially similar to Cboe's electronic FLEX Auction set forth in Cboe Rule 5.72(c), except for certain intended differences as further described below.⁹⁶ Specifically, a Member may electronically submit a FLEX Order (simple or complex) into an electronic FLEX Auction for execution pursuant to this paragraph (b). Pursuant to proposed subparagraph (b)(1), a FLEX Auction may be initiated if all of the below conditions in proposed subparagraph (b)(1)(A)–(G) are met; otherwise, the System rejects or cancels a FLEX Order that does not meet the conditions in this subparagraph (b)(1).⁹⁷

- **Class:** The FLEX Order is in a class of options the Exchange is authorized to list for trading on the Exchange.

- **Size:** There is no minimum size for FLEX Orders.

- **Terms:** A simple or complex FLEX Order must comply with proposed Section 11(a).

- **Price:** The bid or offer price, or the net debit or credit price, as applicable, of the FLEX Order is the “auction price.”

- **Time:** A FLEX Order may only be submitted for electronic execution in a

⁹⁴ See proposed Options 3A, Section 11(a)(2)(A)(i) and (ii), which is materially identical to BOX Rule 7605(d).

⁹⁵ See proposed Options 3A, Section 11(a)(2)(B), which is based on Cboe Rule 5.72(b)(2)(A) except the Exchange will also add references to FLEX PIM and FLEX SOM for accuracy and completeness. The Exchange will also clarify in its proposed rule that the leg prices *when combined must equal* the net price of the complex FLEX Order (additions emphasized). Cboe's rule currently states that the leg prices “must add together to equal” the net price. However, the Exchange notes that sell legs of a complex order are subtracted, and therefore proposes the language in Options 3A, Section 11(a)(2)(B) (instead of copying Cboe Rule 5.72(b)(2)(A)) for greater accuracy.

⁹⁶ See also Securities Exchange Act Release No. 87235 (October 4, 2019), 84 FR 54671 (SR–CBOE–2019–084) (October 10, 2019) (adopting an electronic FLEX Auction on Cboe, among other changes).

⁹⁷ Proposed paragraph (b) is based on Cboe Rule 5.72(c). The proposed eligibility requirements for the FLEX Auction in subparagraph (b)(1) are similar to Cboe Rule 5.72(c)(1), except as noted below.

FLEX Auction after FLEX trading has opened pursuant to proposed Section 8.

- **Exposure Interval:** The submitting Member must designate the length of the “exposure interval,” which must be between three seconds and five minutes.⁹⁸ If the designated time exceeds the market close, then the FLEX Auction will end at the market close with an execution, if an execution is permitted pursuant to proposed Section 11(b).⁹⁹

- **Minimum Increment:** The price of a simple FLEX Order must be in an increment the Exchange determines on a class basis (which may not be smaller than the amounts set forth in proposed Section 5 (*i.e.*, \$0.01)). If the FLEX Order is a complex order, the price must be a net price for the complex strategy.¹⁰⁰ The foregoing rule proposal will be substantially similar to the minimum increment requirements in Cboe Rules 5.73(a)(5) and 5.74(a)(5). While the Exchange will align to Cboe's minimum increment requirements (*i.e.*, \$0.01) for the individual options legs of a complex FLEX Order entered into a FLEX Auction, the Exchange also proposes to align the minimum increment requirements for stock-tied FLEX complex strategies with the existing requirements for stock-tied non-FLEX complex strategies as set forth in Options 3, Section 14(c)(1). As such, proposed Options 3A, Section 11(b)(1)(G) will further provide that the prices of Complex Options Strategies (as defined in Options 3, Section 14) may

⁹⁸ There will be no default setting to the FLEX Auction exposure interval. As such, Members will be required to specify the exposure interval; otherwise, their FLEX Order will be rejected by the System.

⁹⁹ Cboe Rule 5.72(c)(1)(F) does not specify whether an execution would occur (if permitted) when the designated time exceeds the market close, and only expressly prohibits the designated time from going beyond the market close. While the Exchange's rules are silent in this regard, the Exchange notes that its proposal will follow current non-FLEX auction behavior, including current PIM and SOM behavior. In doing so, the Exchange's proposal will promote executions in electronic FLEX Auctions (instead of cancelling the FLEX Order) and also prevent executions that occur after the market close.

¹⁰⁰ See proposed subparagraph (G) of Section 11(b)(1). While Cboe's electronic FLEX Auction eligibility requirements in Rule 5.72(c)(1) are silent on minimum increments, the eligibility requirements for Cboe's FLEX AIM and FLEX SAM in Cboe Rules 5.73(a)(5) and 5.74(a)(5), respectively, address minimum increments. The Exchange believes it will be helpful to add a similar requirement for electronic FLEX Auctions for greater consistency and clarity. The Exchange also notes that unlike Cboe, it is not proposing to allow exercise prices to be expressed as percentages, and will therefore not incorporate the applicable provisions. As discussed above, the Exchange is also incorporating within proposed subparagraph (G) the minimum increment provisions for non-FLEX complex orders that are stock-tied from Options 3, Section 14(c)(1).

be expressed in one cent (\$0.01) increments, and the options leg of Complex Options Strategies may be executed in no smaller than one cent (\$0.01) increments, regardless of the minimum increments otherwise applicable to the individual options legs of the order. Prices of Stock-Option Strategies or Stock-Complex Strategies (each as defined in Options 3, Section 14) may be expressed in any decimal price determined by the Exchange,¹⁰¹ and the stock leg of a Stock-Option Strategy or Stock-Complex Strategy may be executed in any decimal price permitted in the equity market. The options leg of a Stock-Option Strategy or Stock-Complex Strategy may be executed in no smaller than one cent (\$0.01) increments, regardless of the minimum increments otherwise applicable to the individual options legs of the order. Similar to stock-tied complex orders today, the Exchange believes that smaller minimum increments are appropriate for complex FLEX Orders that contain a stock component as the stock component can trade at finer decimal increments permitted by the equity market.

Proposed subparagraph (b)(2) of Options 11 will describe the FLEX Auction process, and will provide that upon receipt of a FLEX Order that meets the conditions in subparagraph (a) as described above, the FLEX Auction commences. Proposed subparagraph (b)(2)(A) will describe the contents of the FLEX Auction message, and will provide that the System initiates a FLEX Auction by sending a FLEX Auction notification message to Members detailing the FLEX Option series or complex strategy (as applicable), side, size, auction ID,¹⁰² capacity, and exposure interval. Similar to all other auction notifications, FLEX Auction notification messages are not

¹⁰¹ The minimum increment for individual options leg of a FLEX Order may not be smaller than \$0.01, as required under proposed Options 3A, Section 5. However, when a stock leg is included in a complex strategy (*i.e.*, Stock-Option Strategy or Stock-Complex Strategy) for the FLEX Option, then the price for FLEX Stock-Option Strategies and FLEX Stock-Complex Strategies can be expressed to four decimal places in order to trade at finer decimal increments permitted by the equity market. However, the options leg will not be permitted to execute in increments smaller than one cent (\$0.01). This is identical to how a non-FLEX Stock-Option Strategy and a non-FLEX Stock-Complex Strategy can be priced today. See Options 3, Section 14(c)(1) for identical provisions. See also Securities Exchange Act Release No. 84373 (October 5, 2018), 83 FR 51730 at 51732 (October 12, 2018) (SR-ISE-2018-56).

¹⁰² As discussed below, this information on the proposed auction message will permit responses to only execute at the conclusion of the auction into which the responses were submitted.

disseminated to OPRA.¹⁰³ Like Cboe, the FLEX Auction message will not include the price of the auctioned FLEX Order. The Exchange believes not including the auction price in the notification message will encourage Members to respond with the best prices at which they are willing to trade against the auctioned FLEX Order. If the message included the price, Members may only respond to trade at that price; without the price, Members may respond at better prices, which may result in price improvement opportunities for the auctioned FLEX Order.

Proposed subparagraph (b)(2)(B) will provide that one or more FLEX Auctions in the same FLEX Option series or complex strategy (as applicable) may occur at the same time. To the extent there is more than one FLEX Auction in a FLEX Option series or complex strategy (as applicable) underway at the same time, the FLEX Auctions conclude sequentially based on the times at which each FLEX Auction's exposure interval concludes. At the time each FLEX Auction concludes, the System allocates the FLEX Order pursuant to proposed subparagraph (3) and takes into account all FLEX responses submitted during the exposure interval.¹⁰⁴ Generally, if a Member attempts to initiate an electronic FLEX Auction in a FLEX Option series while another auction in that series is ongoing, the Exchange believes it will provide that second FLEX Order with an opportunity for execution in a timely manner by initiating another FLEX Auction, rather than having the Member wait for the first auction to conclude. The second Member may not be able to submit a response to trade in the ongoing FLEX Auction, because the terms may not be consistent with that Member's order (for example, there may not be sufficient size, and the Member may only receive a share of the auctioned order depending on other responses). Therefore, the Exchange believes providing this proposed functionality may encourage Members to use electronic FLEX Auctions to execute their FLEX Orders.

Proposed subparagraph (b)(2)(C) will provide that the submitting Member may cancel a FLEX Auction prior to the

¹⁰³ See Cboe Rule 5.72(c)(2)(A) for similar provisions, except with respect to the exposure interval and Attributable designation. The Exchange will simply disseminate the duration of the exposure interval, instead of calculating and disseminating what time the auction will conclude like Cboe. In addition, the Exchange is not proposing to offer an Attributable designation for FLEX Orders like Cboe does today.

¹⁰⁴ See Cboe Rule 5.72(c)(2)(B) for materially identical provisions.

end of the exposure interval.¹⁰⁵ Proposed subparagraph (b)(2)(D) will specify the conditions for submitting responses to a FLEX Auction. Any Member (including the submitting Member) may submit responses to a FLEX Auction that are properly marked specifying the FLEX Option series or complex strategy (as applicable), bid or offer price or net price (respectively), size, side of the market, and the auction ID for the FLEX Auction to which the Member is submitting the response. A FLEX response may only participate in the FLEX Auction with the auction ID specified in the response, which is why the auction notification message described above will include an auction ID and responses must identify the applicable auction ID.¹⁰⁶ If there are concurrent FLEX Auctions occurring, a Member may submit responses to all ongoing auctions, and thus concurrent auctions will not hinder a Member's ability to participate in any FLEX Auction.

A Member using the same badge/¹⁰⁷ mnemonic¹⁰⁸ may only submit a single FLEX response per auction ID to a FLEX Auction.¹⁰⁹ If an additional FLEX response is submitted for the same auction ID from the same badge/mnemonic, then that FLEX response will automatically replace the previous FLEX response.¹¹⁰ The System caps the size of a FLEX response for the same badge/mnemonic at the size of the FLEX Order (*i.e.*, the System ignores the size in excess of the size of the FLEX Order when processing the FLEX Auction).¹¹¹

¹⁰⁵ See Cboe Rule 5.72(c)(2)(C) for materially identical provisions. The Exchange notes that submitting Members may cancel but not modify a FLEX Auction prior to the end of the exposure interval.

¹⁰⁶ See Cboe Rule 5.72(c)(2)(D) for materially identical provisions.

¹⁰⁷ A "badge" shall mean an account number, which may contain letters and/or numbers, assigned to Market Makers. A Market Maker account may be associated with multiple badges. See Options 1, Section 1(a)(5).

¹⁰⁸ A "mnemonic" shall mean an acronym comprised of letters and/or numbers assigned to Electronic Access Members. An Electronic Access Member account may be associated with multiple mnemonics. See Options 1, Section 1(a)(23).

¹⁰⁹ A badge and mnemonic are essentially Member identifiers. Every order that comes into the System is tied to a badge or mnemonic.

¹¹⁰ In other words, the Member does not have to cancel the previous FLEX response before submitting an additional one as the previous response is *automatically* replaced. See proposed Options 3A, Section 11(b)(2)(D)(i), which is based on Cboe Rule 5.72(c)(2)(D)(i) except the Exchange will not allow Members to submit multiple FLEX responses using the same badge/mnemonic, and will not aggregate all of the Member's FLEX responses. While not specified in the Exchange's current rules, this is consistent with current auction behavior, including current PIM and SOM behavior.

¹¹¹ See proposed Options 3A, Section 11(b)(2)(D)(ii), which is based on Cboe Rule

Given that the Exchange is proposing below to apply a pro-rata allocation methodology to executions at the conclusion of the FLEX Auction, this provision is intended to prevent a Member from submitting a response with an extremely large size into the electronic FLEX Auction in order to obtain a larger pro-rata share of the FLEX Order.

Further, FLEX responses must be on the opposite side of the market as the FLEX Order. The System rejects a FLEX response on the same side of the market as the FLEX Order.¹¹² FLEX responses are not visible to Members or disseminated to OPRA.¹¹³ This is consistent with how Cboe treats FLEX responses pursuant to Cboe Rule 5.72(c)(2)(D)(iv). The proposed rule change is also consistent with the Exchange's existing auctions, in which responses are not visible to the market.¹¹⁴ Responses to electronic auctions are not firm prior to the conclusion of the auction, at which time their price and size are firm. For the same reason as the Exchange is proposing not to disseminate the auction price on the auction notification message as discussed above, the Exchange believes it will encourage Members to submit responses at their best possible price if they do not know the prices at which other Members are willing to trade.¹¹⁵

A Member may modify or cancel its FLEX Responses during the exposure interval.¹¹⁶ The minimum price increment for FLEX responses is the same as the one the Exchange determines for a class pursuant to proposed subparagraph (b)(1)(G) above. A response to a FLEX Auction of a complex order must have a net price. The System rejects a FLEX response that

5.72(c)(2)(D)(ii) except the Exchange will not aggregate all of the Member's FLEX responses. See *supra* note 110.

¹¹² See proposed Options 3A, Section 11(b)(2)(D)(iii), which is based on Cboe Rule 5.72(c)(2)(D)(iii).

¹¹³ See proposed Options 3A, Section 11(b)(2)(D)(iv), which is based on Cboe Rule 5.72(c)(2)(D)(iv).

¹¹⁴ See Supplementary Material .02 to Options 3, Section 11; and Options 3, Section 13(c)(4).

¹¹⁵ For example, if during a FLEX Auction of a buy FLEX Order, a Member submitted a response to sell at \$1.05, if another Member saw that response, it may merely respond to sell at \$1.05, or maybe \$1.04, even though it may ultimately be willing to sell at \$1.03. Without seeing the other responses, the second Member may instead submit a response to sell at \$1.03, which could result in price improvement for the auctioned order.

¹¹⁶ See proposed Options 3A, Section 11(b)(2)(D)(v), which is based on Cboe Rule 5.72(c)(2)(D)(v).

is not in the applicable minimum increment.¹¹⁷

Pursuant to proposed subparagraph (b)(3) of Section 11, the FLEX Auction concludes at the end of the exposure interval, unless the Exchange halts trading in the affected underlying or the submitting Member cancels the FLEX Auction before the end of the exposure interval, in which case the FLEX Auction concludes without execution.¹¹⁸ At the conclusion of the FLEX Auction:

- Pursuant to proposed subparagraph (b)(3)(A), the System executes the FLEX Order against the FLEX responses at the best price(s), to the price at which the balance of the FLEX Order or the FLEX responses can be fully executed (the "final auction price"). For purposes of ranking FLEX responses when determining how to allocate a FLEX Order, the term "price" refers to the dollar and decimal amount of the response bid or offer.¹¹⁹
- Pursuant to proposed subparagraph (b)(3)(A)(i), if there are multiple FLEX responses at the same price level, then the contracts in those FLEX responses are allocated proportionally according to Size Pro-Rata Priority¹²⁰ with Priority Customer¹²¹ overlay¹²² (as described in

¹¹⁷ See proposed Options 3A, Section 11(b)(2)(D)(vi). While Cboe's electronic FLEX Auction response requirements in Rule 5.72(c)(2)(D) are silent on minimum increments, the response requirements for Cboe's FLEX AIM and FLEX SAM in Cboe Rules 5.73(c)(5)(A) and 5.74(c)(5)(A), respectively, have similar provisions. The Exchange believes it will be helpful to add a similar requirement for electronic FLEX Auction responses for greater consistency and clarity. The Exchange also notes that unlike Cboe, it is not proposing to allow percentage formats for exercise prices of FLEX Options, and will therefore not incorporate the applicable provisions.

¹¹⁸ See Cboe Rule 5.72(c)(3) for similar provisions, except the Exchange is making minor modifications to replace "affected series" with "affected underlying" and to specify that the submitting Member has to cancel the FLEX Auction before the end of the exposure period. The foregoing changes are merely clarifications to better articulate the functionality.

¹¹⁹ See Cboe Rule 5.72(c)(3)(A) for similar provisions, except the Exchange is not proposing to allow percentage values of the response bid or offer.

¹²⁰ Size Pro-Rata Priority shall mean that if there are two or more resting orders or quotes at the same price, the System allocates contracts from an incoming order or quote to resting orders and quotes beginning with the resting order or quote displaying the largest size proportionally according to displayed size, based on the total number of contracts displayed at that price. See Options 3, Section 10(c).

¹²¹ The term "Priority Customer" means a person or entity that (i) is not a broker or dealer in securities, and (ii) does not place more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). See Options 1, Section 1(a)(37).

¹²² Priority Customer overlay mean that the highest bid and lowest offer shall have priority except that Priority Customer orders shall have priority over non-Priority Customer interest at the

Options 3, Section 10(c)(1)(A)). The Exchange notes that this is similar to Cboe Rule 5.72(c)(3)(A)(i), except Cboe applies no overlays to its size pro-rata allocation methodology whereas the Exchange will apply an overlay for Priority Customers on top of its standard size pro-rata allocation methodology. This is consistent with the Exchange's standard allocation methodology in its SOM and PIM for non-FLEX Options where the Priority Customer gets priority treatment over non-Priority Customers.¹²³

- Pursuant to proposed subparagraph (b)(3)(A)(ii), the executable quantity is allocated to the nearest whole number, with fractions rounded up for the FLEX response with the higher quantity. Further, proposed subparagraph (b)(3)(A)(iii) will provide that if an allocation would result in less than one contract, then one contract will be allocated. The Exchange is not adopting the rounding and allocation language in Cboe Rule 5.72(c)(3)(A)(ii) and (iii), but is rather adopting language that is consistent with its current rounding and allocation methodology as the Exchange does not allocate fractional contracts and instead rounds up to the nearest whole number.¹²⁴

Pursuant to proposed subparagraph (b)(3)(B), the System cancels an unexecuted FLEX Order (or unexecuted portion).¹²⁵ Further, proposed subparagraph (b)(3)(C) will provide that the System cancels any unexecuted responses (or unexecuted portions).¹²⁶

M. FLEX PIM (Section 12)

The Exchange proposes to establish PIM auction functionality for FLEX Options in Options 3A, Section 12. The proposed FLEX PIM auction will be substantially similar to Cboe's FLEX AIM in Cboe Rule 5.73, except for certain intended differences as further described below. Pursuant to proposed Section 12, a Member (the "Initiating Member") may electronically submit for execution an order (which may be a simple or complex order) it represents as agent ("Agency Order") against

same price in the same options series. If there are two or more Priority Customer orders for the same options series at the same price, priority shall be afforded to such Priority Customer orders in the sequence in which they are received by the System. See Options 10, Section 10(c)(1)(A).

¹²³ See, e.g., Options 3, Section 11(d)(3)(C) (SOM allocation methodology) and Options 3, Section 13(d) (PIM allocation methodology).

¹²⁴ See Options 3, Section 10(c), Supplementary Material .09 to Options 3, Section 11, and Supplementary Material .10 to Options 3, Section 13.

¹²⁵ See Cboe Rule 5.72(c)(3)(B) for materially identical provisions.

¹²⁶ See Cboe Rule 5.72(c)(3)(C) for materially identical provisions.

principal interest or a solicited order(s) (except, if the Agency Order is a simple order, for an order for the account of any FLEX Market Maker with an appointment in the applicable FLEX Option class on the Exchange) (an “Initiating Order”), provided it submits the Agency Order for electronic execution into a FLEX PIM auction pursuant to this Rule.¹²⁷

Proposed Section 12(a)(1)–(5) will set forth the FLEX PIM auction eligibility requirements. Specifically, the Initiating Member may initiate a FLEX PIM auction if all of the following conditions are met:

- **Class.** An Agency Order must in a FLEX Option class the Exchange designates as eligible for FLEX PIM auctions.

- **FLEX Option Series.** The Agency Order and Initiating Order must each be a FLEX Order that complies with proposed Section 11(a) in a permissible FLEX Option series that complies with proposed Section 3 above. For a complex FLEX Order, each leg must be in a permissible FLEX option series that complies with proposed Section 3 above.¹²⁸

- **Marking.** The Initiating Member must mark an Agency Order for FLEX PIM auction processing.

- **Size.** There will be no minimum size for Agency Orders. The Initiating Order must be for the same size as the Agency Order.

- **Minimum Increment.** The price of the Agency Order and Initiating Order for simple FLEX Orders must be in an increment the Exchange determines on a class basis (which may not be smaller than the amounts set forth in Section 5 above). If the Agency Order and Initiating Order are complex orders, the price must be a net price for the complex strategy.¹²⁹ While the Exchange will align to Cboe’s minimum increment requirements (*i.e.*, \$0.01) for the individual options legs of a complex FLEX Order entered into a FLEX PIM, the Exchange also proposes to align the minimum increment requirements for stock-tied FLEX complex strategies with

the existing requirements for stock-tied non-FLEX complex strategies as set forth in Options 3, Section 14(c)(1). As such, proposed Options 3A, Section 12(a)(5) will further provide that the prices of Complex Options Strategies (as defined in Options 3, Section 14) may be expressed in one cent (\$0.01) increments, and the options leg of Complex Options Strategies may be executed in no smaller than one cent (\$0.01) increments, regardless of the minimum increments otherwise applicable to the individual options legs of the order. Prices of Stock-Option Strategies or Stock-Complex Strategies (each as defined in Options 3, Section 14) may be expressed in any decimal price determined by the Exchange,¹³⁰ and the stock leg of a Stock-Option Strategy or Stock-Complex Strategy may be executed in any decimal price permitted in the equity market. The options leg of a Stock-Option Strategy or Stock-Complex Strategy may be executed in no smaller than one cent (\$0.01) increments, regardless of the minimum increments otherwise applicable to the individual options legs of the order. Similar to stock-tied complex orders today, the Exchange believes that smaller minimum increments are appropriate for complex FLEX Orders that contain a stock component as the stock component can trade at finer decimal increments permitted by the equity market.

- **Time.** An Initiating Member may only submit an Agency Order to a FLEX PIM auction after trading in FLEX Options is open pursuant to proposed Section 8.

The System will reject or cancel both an Agency Order and Initiating Order submitted to a FLEX PIM auction that do not meet the conditions in proposed paragraph (a) as described above. The proposed FLEX PIM eligibility requirements in proposed Section 12(a) are substantially similar to Cboe’s FLEX AIM eligibility requirements in Cboe Rule 5.73(a), except with respect to the language related to the percentage value, as noted above.

Pursuant to proposed Section 12(b), the Initiating Order must stop the entire Agency Order at a specified price. If the Agency Order and Initiating Order are Complex Orders, the price must be a net

price for the complex strategy.¹³¹ In particular, the Initiating Member must specify either of the below; otherwise, the System will reject or cancel both an Agency Order and Initiating Order submitted to a FLEX PIM auction that do not meet the conditions in this proposed paragraph (b).

- Pursuant to proposed subparagraph (b)(1), a single price at which it seeks to execute the Agency Order against the Initiating Order (a “single-price submission”), including whether it elects to have less than its guaranteed allocation (as described in proposed Section 12(e)(4) below). This is similar to Cboe Rule 5.73(b)(1), except the Exchange is not proposing to allow Initiating Members to elect for the Initiating Order to have last priority to trade against the Agency Order, and will instead allow them to elect less than their guaranteed allocation.¹³² As further discussed below, the proposed guaranteed allocation process will be based on the guaranteed allocation process available in non-FLEX PIM auctions, and therefore the proposed rule change will provide further consistency across the Exchange’s auction mechanism processes.¹³³

- Pursuant to subparagraph (b)(2), an initial stop price and instruction to automatically match the price and size of all FLEX PIM responses (“auto-match”) at each price, up to a designated limit price, better than the price at which the balance of the Agency Order can be fully executed (the “final auction price”). This is materially identical to Cboe Rule 5.73(b)(2).

Proposed Section 12(c) will govern the FLEX PIM auction process. Specifically, upon receipt of an Agency

¹³¹ See Cboe Rule 5.73(b) for similar provisions, except the Exchange will not allow prices to be entered as a percentage value, and therefore will not incorporate the applicable language from Cboe’s rule into proposed Section 12(b).

¹³² The Exchange will allow the Initiating Member to customize their guaranteed allocation percentage of the Initiating Order anywhere from 0% up to 50% of the Agency Order (if there is a response(s) from one other Member at the same price) or up to 40% of the Agency Order (if there are responses from two or more Members at the same price). For example, an Agency Order is entered into FLEX PIM for 100 contracts. If the Initiating Member only wants to have a guaranteed allocation of 10% on the Initiating Order that was entered with the Agency Order, the Initiating Member can stipulate 10% on the Initiating Order. If there are 4 FLEX PIM responses for a total of 200 contracts at the end of the auction, then the Initiating Member will only get 10 contracts allocated on its Initiating Order (*i.e.*, the guaranteed 10% of 100 contracts). Cboe’s rule does not allow for the Initiating Member’s guaranteed allocation percentages to be customized. See *infra* note 158 for further discussion on the 50%/40% allocation percentages.

¹³³ See *infra* note 158 for further discussion on the 50%/40% allocation percentages.

¹²⁷ See Cboe Rule 5.73 for similar provisions, except the Exchange will not incorporate the reference to FLEX SPX as this is a Cboe-specific product.

¹²⁸ See Cboe Rule 5.73(a)(2) for similar provisions, except the Exchange will add a similar stipulation for each leg of a complex FLEX Order for clarity.

¹²⁹ The Exchange notes that unlike Cboe, it will not allow prices to be entered as a percentage value, and therefore will not incorporate the applicable language from Cboe Rule 5.73(a)(5) into proposed Section 12(a)(5). As discussed above, the Exchange will also add existing complex order minimum increment requirements in Options 3, Section 14(c)(1) to align the proposed FLEX functionality with non-FLEX functionality.

¹³⁰ The prices of the FLEX Stock-Option Strategies and FLEX Stock-Complex Strategies can be expressed to four decimal places, which is identical to how the stock portion of a non-FLEX Stock-Option Strategy and a non-FLEX Stock-Complex Strategy can be priced today. However, the options leg will not be permitted to execute in increments smaller than one cent (\$0.01). See *supra* note 101.

Order that meets the conditions in paragraphs (a) and (b) as described above, the FLEX PIM auction process commences. Proposed subparagraphs (c)(1)(A) and (B) will describe concurrent FLEX PIM auctions for simple Agency Orders and complex Agency Orders, respectively. One or more FLEX PIM auctions in the same FLEX Option series or same complex strategy (as applicable) may occur at the same time.¹³⁴ To the extent there is more than one FLEX PIM auction in a FLEX Option series or complex strategy (as applicable) underway at the same time, the FLEX PIM auctions will conclude sequentially based on the times at which the FLEX PIM auction periods end. At the time each FLEX PIM auction concludes, the System allocates the Agency Order pursuant to proposed paragraph (e) as described below, and takes into account all FLEX PIM responses received during the FLEX PIM auction period. The concurrent FLEX PIM auction feature in proposed Section 12(c)(1)(A) and (B) is materially identical to Cboe Rule 5.73(c)(1)(A) and (B), and is also consistent with the concurrent auction feature proposed above for FLEX Auctions. Similar to FLEX Auctions as proposed above, if a Member attempts to initiate a FLEX PIM Auction in a FLEX Option series while another auction in that series is ongoing, the Exchange believes it will provide that second FLEX Order with an opportunity for execution in a timely manner by initiating another FLEX PIM Auction, rather than requiring the Member to wait for the first auction to conclude. The second Member may not be able to submit a response to trade in the ongoing FLEX PIM Auction because the terms may not be consistent with that Member's order (for example, there may not be sufficient size, and the Member may only receive a share of the auctioned order depending on other responses). Therefore, the Exchange believes that providing this functionality for FLEX PIM may provide additional opportunities for execution of FLEX Orders by encouraging Members to use FLEX PIM.

Pursuant to proposed Section 12(c)(2), the System initiates the FLEX PIM auction process by sending a FLEX PIM auction notification message detailing the side, size, auction ID, the length of the FLEX PIM auction period, and FLEX

Option series or complex strategy, as applicable, of the Agency Order to all Members that elect to receive FLEX PIM auction notification messages. The Exchange may also determine to include the stop price in FLEX PIM auction notification messages, which will apply to all FLEX PIM auctions. Similar to all other auction notifications, FLEX PIM auction notification messages will not be disseminated to OPRA.¹³⁵

Proposed Section 12(c)(3) will describe the "FLEX PIM Auction period," and is based on Cboe Rule 5.73(c)(3). The FLEX PIM Auction period will be defined as a period of time that must be designated by the Initiating Member, which may be no less than three seconds and no more than five minutes. Similar to the exposure interval for electronic FLEX Auctions in Section 11(b) discussed above, the Initiating Member will be required to identify a length of time within the specified parameters for FLEX PIM as there will be no default for the FLEX PIM Auction period. Otherwise, their FLEX Order will be rejected by the System. Further, if the designated length of the FLEX PIM Auction period exceeds the market close, then the auction will end at the market close with an execution, if an execution is permitted by this Section 12. Cboe's rule does not specify whether an execution (if permitted) would occur if the designated length exceeds the market close. However, the Exchange's non-FLEX auctions currently allow executions (as permitted by their respective rules) to occur in such scenarios, so the Exchange proposes to be consistent with current System functionality in this regard.¹³⁶ In doing so, the Exchange's proposal will promote executions in FLEX PIM (instead of cancelling the FLEX Order) and also prevent executions from occurring after the market close.

Proposed Section 12(c)(4) will provide that an Initiating Member may not modify or cancel an Agency Order or Initiating Order after submission to a FLEX PIM auction, except to improve the price of the Initiating Order. This will be similar to Cboe Rule 5.73(c)(4) except unlike Cboe, the Exchange will allow a limited exception by allowing Initiating Members to improve the price of their Initiating Orders. The Exchange notes that this will align to current non-

FLEX PIM behavior, which allows entering Members to modify their Counter-Side Orders¹³⁷ upon entry into the PIM by improving upon the initial price of the Counter-Side Order.¹³⁸ Similar to allowing the initiating Member of a non-FLEX PIM to improve the initial price of its Counter-Side Order, the Exchange believes that it is appropriate to allow the Initiating Member of the FLEX PIM to improve the price of its Initiating Order (*i.e.*, contra-side to the Agency Order) because it would also improve the stop price of the Agency Order that came in together with the Initiating Order.¹³⁹

Proposed Section 12(c)(5) will govern the requirements for FLEX PIM responses. Specifically:

- Any Member other than the Initiating Member (the System rejects a response with the same badge/mnemonic as the Initiating Order) may submit responses to a FLEX PIM auction that are properly marked specifying price, size, side, and the auction ID for the FLEX PIM auction to which the Member is submitting the response. A FLEX PIM response may only participate in the FLEX PIM auction with the auction ID specified in the response.¹⁴⁰
- The minimum price increment for FLEX PIM responses is the same as the one the Exchange determines for a class pursuant to proposed Section 12(a)(5) above. A response to a FLEX PIM auction of a complex Agency Order must have a net price. The System will reject a FLEX PIM response that is not in the applicable minimum increment.¹⁴¹
- A Member using the same badge/mnemonic may only submit a single

¹³⁷ Counter-Side Orders (*i.e.*, contra-side to the Agency Order) for PIM are functionally equivalent to Initiating Orders (*i.e.*, contra-side order to the Agency Order) for FLEX PIM. See Options 3, Section 13(b) for a description of Counter-Side Orders.

¹³⁸ See Options 3, Section 13(b)(5) (providing that the Crossing Transaction may not be canceled or modified, but the price of the Counter-Side Order may be improved during the exposure period).

¹³⁹ As proposed, the Initiating Member enters a paired FLEX Order into FLEX PIM consisting of an Agency Order and an Initiating Order (which is the contra-side of the Agency Order). This is identical to how standard non-FLEX PIM works today in that the Initiating Member enters a paired order into standard PIM consisting of an Agency Order and a Counter-Side Order (*i.e.*, the PIM Agency Order's contra-side, and the functional equivalent to an Initiating Order on FLEX PIM).

¹⁴⁰ See proposed Options 3A, Section 12(c)(5), which is based on Cboe Rule 5.73(c)(5).

¹⁴¹ See proposed Options 3A, Section 12(c)(5)(A), which is based on Cboe Rule 5.73(c)(5)(A) except the Exchange will not allow prices to be expressed as a percentage value. Further, the Exchange will not incorporate the Cboe rule portions on Index Combo Orders as the Exchange does not offer this functionality.

¹³⁴ Further, for complex Agency Orders, PIM auctions in different complex strategies may be ongoing at any given time, even if the complex strategies have overlapping components. A FLEX PIM auction in a complex strategy may be ongoing at the same time as a FLEX PIM auction in any component of the complex strategy. See proposed subparagraph (c)(1)(B)(i) of Options 3A, Section 12.

¹³⁵ See Cboe Rule 5.73(c)(2) for substantially similar provisions except the Exchange will not incorporate the reference to SPX as it does not list this symbol.

¹³⁶ While this behavior is not explicitly stated in the current Rules, the Exchange's proposal will be consistent with current non-FLEX auction behavior, including current PIM and SOM behavior.

FLEX PIM response per auction ID for a given auction. If an additional FLEX PIM response is submitted for the same auction ID from the same badge/mnemonic, then that FLEX PIM response will automatically replace the previous FLEX PIM response.¹⁴²

- The System will cap the size of a FLEX PIM response at the size of the Agency Order (*i.e.*, the System will ignore size in excess of the size of the Agency Order when processing the FLEX PIM auction).¹⁴³

- FLEX PIM responses must be on the opposite side of the market as the Agency Order. The System rejects a FLEX PIM response on the same side of the market as the Agency Order.¹⁴⁴

- FLEX PIM responses will not be visible to PIM auction participants or disseminated to OPRA.¹⁴⁵

- A Member may modify or cancel its FLEX PIM responses during the FLEX PIM auction.¹⁴⁶

Pursuant to proposed Section 12(d), a FLEX PIM auction concludes at the earliest to occur of the following times: (1) the end of the FLEX PIM auction period; and (2) any time the Exchange halts trading in the affected underlying, provided, however, that in such instance the FLEX PIM auction concludes without execution.¹⁴⁷

Proposed Section 12(e) will govern how executions will occur in FLEX PIM. In particular, at the end of the FLEX PIM auction, the System allocates the Initiating Order or FLEX PIM responses against the Agency Order at the best price(s), to the price at which the balance of the Agency Order can be

fully executed (the “final auction price”), as follows. For purposes of ranking the Initiating Order and FLEX PIM responses when determining how to allocate the Agency Order against the Initiating Order and those responses, the term “price” refers to the dollar and decimal amount of the order or response bid or offer.¹⁴⁸ Proposed subparagraphs (e)(1)–(4) details the FLEX PIM allocation methodology for the following scenarios:

- *No Price Improvement*: If the FLEX PIM auction results in no price improvement, the System executes the Agency Order at the stop price in the following order:

- Priority Customer responses (in time priority);¹⁴⁹

- The Initiating Order for the greater of (1) one contract or (2) up to 50% of the Agency Order if there is a response(s) from one other Member at the same price or 40% of the Agency Order if there are responses from two or more other Members at the same price (which percentages are based on the original size of the Agency Order).¹⁵⁰ Unless there are remaining contracts after including all PIM responses, under no circumstances does the Initiating Member receive an allocation percentage at the final auction price of more than 50% of the initial Agency Order in the event there is a response(s) from one other Member or 40% of the initial Agency Order in the event there are responses from two or more other Members, except when rounding up. The Exchange is specifying two limited scenarios in this Rule where the Initiating Member may receive an allocation percentage greater than its guaranteed allocation percentage, which is either when there are remaining contracts after including all PIM responses or when rounding up.¹⁵¹ As an example of the first scenario, assume an Initiating Member submitted a FLEX

Order for 20 contracts into FLEX PIM and there are 2 PIM responses (one for 3 contracts and one for 4 contracts). After the 7 PIM responses are allocated, the Initiating Member would then receive the remaining 13 contracts (which is more than their 40% allocation percentage) because there are remaining contracts after all PIM responses are included.

- All other FLEX PIM responses, allocated on a Size Pro-Rata basis (as defined in Options 3, Section 10(c));¹⁵² and

- The Initiating Order to the extent there are any remaining contracts.¹⁵³

- *Price Improvement With Single-Price Submission*: If the FLEX PIM auction results in price improvement for the Agency Order and the Initiating Member selected a single-price submission, at each price better than the final auction price, the System executes the Agency Order in the following order:

- Priority Customer responses (in time priority);¹⁵⁴

- Other FLEX PIM responses (in time priority) at prices better than the final auction price; and

- All other FLEX PIM responses at the final auction price, allocated on a Size Pro-Rata basis (as defined in Options 3, Section 10(c)).¹⁵⁵

For example, assume a FLEX PIM Agency Order is sent for 100 contracts with a price of \$1.00 and the Initiating Member selected a single-price submission. There are two PIM responses for 5 contracts each at \$0.98, two PIM responses for 20 contracts each at \$0.99, and two PIM responses for 40 contracts each at \$1.00. The PIM responses at \$0.98 and \$0.99 will be executed in their entirety. The PIM responses at \$1.00 (final auction price) will be executed on a Size Pro-Rata basis. At the final auction price, the System executes any remaining contracts from the Agency Order at that

¹⁴² See proposed Options 3A, Section 12(c)(5)(B), which will be different from Cboe Rule 5.73(c)(5)(B) because the Exchange will not allow Members to submit multiple FLEX PIM responses using the same badge/mnemonic, and will not aggregate all of the Member's FLEX PIM responses. While the rules are currently silent in this regard, this will align to current non-FLEX auction behavior, including PIM auction behavior.

¹⁴³ See proposed Options 3A, Section 12(c)(5)(C), which is based on Cboe Rule 5.73(c)(5)(C) except the Exchange will not allow Members to submit multiple FLEX PIM responses using the same badge/mnemonic, and will not aggregate all of the Member's FLEX PIM responses. As noted above, this will align to current non-FLEX auction functionality, including PIM auction functionality in Options 3, Section 13.

¹⁴⁴ See proposed Options 3A, Section 12(c)(5)(D), which is materially identical to Cboe Rule 5.73(c)(5)(D).

¹⁴⁵ See proposed Options 3A, Section 12(c)(5)(E), which is materially identical to Cboe Rule 5.73(c)(5)(E).

¹⁴⁶ See proposed Options 3A, Section 12(c)(5)(F), which is materially identical to Cboe Rule 5.73(c)(5)(F).

¹⁴⁷ See Cboe Rule 5.73(d) for similar provisions, except the Exchange will make a minor clarification that this rule applies when the Exchange halts trading in the affected underlying (and not series, which is what Cboe currently has in its rule).

¹⁴⁸ See Cboe Rule 5.73(e) for similar provisions except the Exchange will not allow prices to be expressed as a percentage value.

¹⁴⁹ See proposed Section 12(e)(1)(A), which is materially identical to Cboe Rule 5.73(e)(1)(A).

¹⁵⁰ See proposed Section 12(e)(1)(B)(ii), which is based on Cboe Rule 5.73(e)(1)(B)(ii) except the percentages will be based on the original size of the Agency Order, instead of the number of contracts remaining after execution against Priority Customer responses like Cboe. This will align to current PIM functionality. See Options 3, Section 13(d)(3). See *infra* note 158 for further discussion on the 50%/40% allocation percentages.

¹⁵¹ See proposed Section 12(e)(1)(B), which is based on Cboe Rule 5.73(e)(1)(B) except with respect to the two limited scenarios discussed above. This behavior relating to the remaining contracts scenario and rounding up scenario will align to current PIM functionality. While the Exchange's rules are silent on the first scenario, the rounding up scenario is specified in Options 3, Section 13(d)(7).

¹⁵² See proposed Section 12(e)(1)(C), which is materially identical to Cboe Rule 5.73(e)(1)(C). The Exchange notes that Size Pro-Rata (as defined in Options 3, Section 10(c)) is similar to pro-rata as referenced in the Cboe rule (and as defined in Cboe Rule 5.32(a)(1)(B)).

¹⁵³ See proposed Section 12(e)(1)(D), which is materially identical to Cboe Rule 5.73(e)(1)(D).

¹⁵⁴ See proposed Section 12(e)(2)(A), which is materially identical to Cboe Rule 5.73(e)(2)(A).

¹⁵⁵ See proposed Section 12(e)(2)(B), which is based on Cboe Rule 5.73(e)(2)(B), except the Exchange will specify that other FLEX PIM responses at prices better than the final auction price will be allocated in time priority and all other FLEX PIM responses at the final auction price will be allocated on a Size Pro-Rata Basis. While the current rules are silent in this regard, this behavior follows current System behavior for its PIM functionality.

price in the order set forth in proposed Section 12(e)(1), as described above.¹⁵⁶

- *Price Improvement With Auto-Match*: If the FLEX PIM auction results in price improvement for the Agency Order and the Initiating Member selected auto-match, at each price better than the final auction price up to the designated limit price, the System executes the Agency Order against the Initiating Order for the number of contracts equal to the aggregate size of all FLEX PIM responses and then executes the Agency Order against those responses in the order set forth in proposed subparagraph (e)(2) described above. At the final auction price, the System executes contracts at that price in the order set forth in proposed subparagraph (e)(1) described above.¹⁵⁷

- *Guaranteed Allocation*: If the Initiating Member selects a single-price submission, it may elect for the Initiating Order to have less than their guaranteed allocation (50% if there is a response(s) from one other Member or 40% if there are responses from two or more Members) to trade against the Agency Order. The Initiating Member may select a lesser percentage than their guaranteed allocation. If the Initiating Member elects 0%, then notwithstanding subparagraphs (e)(1) and (2), the System only executes the Initiating Order against any remaining Agency Order contracts at the stop price after the Agency Order is allocated to all FLEX PIM responses at all prices equal to or better than the stop price. Guaranteed allocation information is not available to other market participants and may not be modified after it is submitted.¹⁵⁸

¹⁵⁶ See proposed Section 12(e)(2), which is materially identical to Cboe Rule 5.73(e)(2).

¹⁵⁷ See proposed Section 12(e)(3), which is materially identical to Cboe Rule 5.73(e)(3).

¹⁵⁸ See proposed Section 12(e)(4), which is based on Cboe Rule 5.73(e)(4) except the Exchange will replace Cboe's last priority feature with a guaranteed allocation feature similar to current PIM functionality that allows Members to request a lower percentage than their guaranteed allocation. See Options 3, Section 13(d)(3). As such, the difference between Cboe's rule and ISE's rule will be that ISE Members will be able to customize their guaranteed allocation percentages for FLEX PIM (which will follow the non-FLEX PIM process) while Cboe's rules do not seem to allow this for FLEX AIM. The Exchange notes that the proposed guaranteed allocation percentages of 50% (if there is a response(s) from one other Member) and 40% (if there are responses from two or more Members) for FLEX PIM will differ from the current guaranteed allocation percentage of 40% for standard PIM. As such, the Exchange is aligning to Cboe's allocation percentages. The Exchange also notes that its affiliates, Nasdaq BX, Inc. ("BX") and Nasdaq PHLX LLC ("Phlx"), have consistent guaranteed allocation percentages for their standard non-FLEX price improvement auctions, BX PRISM and Phlx PIXL. See BX Options 3, Section 13(ii)(A)(1) and Phlx Options 3, Section 13(b)(5)(B).

Pursuant to proposed Section 12(e)(5), the System cancels any unexecuted FLEX PIM responses (or unexecuted portions) at the conclusion of the FLEX PIM auction.¹⁵⁹

Lastly, the Exchange proposes a number of policies applicable to FLEX PIM as Supplementary Materials to Options 3A, Section 12. Specifically, proposed Supplementary Material .01 will provide that a Member may only use a FLEX PIM auction where there is a genuine intention to execute a bona fide transaction.¹⁶⁰ Proposed Supplementary Material .02 will provide that it will be deemed conduct inconsistent with just and equitable principles of trade and a violation of Options 9, Section 1¹⁶¹ to engage in a pattern of conduct where the Initiating Member breaks up an Agency Order into separate orders for the purpose of gaining a higher allocation percentage than the Initiating Member would have otherwise received in accordance with the allocation procedures contained in proposed paragraph (e) above.¹⁶² Lastly, proposed Supplementary Material .03 will provide that if an allocation would result in less than one contract, then one contract will be allocated.¹⁶³ This aligns to how the Exchange currently allocates contracts in PIM.¹⁶⁴

N. FLEX SOM (Section 13)

The Exchange proposes to establish SOM auction functionality for FLEX Options in Options 3A, Section 13. The proposed FLEX SOM auction will be substantially similar to Cboe's FLEX SAM in Cboe Rule 5.74, except for certain intended differences to align with the Exchange's current System functionality for non-FLEX Options, as further described below. Pursuant to proposed Section 13, a Member (the

¹⁵⁹ See Cboe Rule 5.73(e)(5) for substantially similar provisions.

¹⁶⁰ See Cboe Rule 5.73, Interpretations and Policies .01 for materially identical provisions.

¹⁶¹ Options 9, Section 1 provides that no Member shall engage in acts or practices inconsistent with just and equitable principles of trade. Persons associated with Members shall have the same duties and obligations as Members under the Rules of Options 9.

¹⁶² See Cboe Rule 5.73, Interpretations and Policies .02 for materially identical provisions.

¹⁶³ The Exchange notes that it is not proposing to add the provision from Cboe Rule 5.73, Interpretations and Policies .03 that states: "A FLEX Official may nullify a transaction following a FLEX AIM Auction pursuant to Rule 5.75(b)." Because the FLEX Official is a floor concept and the Exchange does not operate a trading floor, the Exchange will not incorporate this concept into its proposed FLEX rules. Instead, the Exchange will System-enforce this provision by rejecting a FLEX PIM auction that does not comply with the provisions in proposed Options 3A, Section 12.

¹⁶⁴ See Supplementary Material .10 to Options 3, Section 13.

"Initiating Member") may electronically submit for execution an order (which may be a simple or complex order) it represents as agent ("Agency Order") against a solicited order ("Solicited Order") if it submits the Agency Order for electronic execution into a FLEX SOM auction pursuant to this Rule.¹⁶⁵

Proposed Section 13(a)(1)–(6) will set forth the FLEX SOM auction eligibility requirements, and will be substantially similar to Cboe Rule 5.74(a)(1)–(6) except as noted below. Specifically, the Initiating Member may initiate a FLEX SOM auction if all of the following conditions are met:

- *Class*. An Agency Order must in a FLEX Option class the Exchange designates as eligible for FLEX SOM auctions.
- *FLEX Option Series*. The Agency Order and Solicited Order must each be a FLEX Order that complies with proposed Section 11(a) in a permissible FLEX Option series that complies with proposed Section 3 above. For a complex FLEX Order, each leg must be in a permissible FLEX option series that complies with Section 3 above.¹⁶⁶
- *Marking*. The Initiating Member must mark an Agency Order for FLEX SOM auction processing.
- *Size*. The Agency Order must be for at least the minimum size designated by the Exchange (which may not be less than 500 standard option contracts). For complex FLEX Orders, this minimum size requirement will apply to each leg. The Solicited Order must be for the same size as the Agency Order. The System handles each of the Agency Order and the Solicited Order as all-or-none.¹⁶⁷

¹⁶⁵ See Cboe Rule 5.74 for similar provisions, except the Exchange will not add Cboe's language that the Solicited Order cannot have a Capacity F (*i.e.*, Firm capacity) for the same executing firm ID ("EFID") as the Agency Order for the foregoing reasons. Facilitated orders cannot be entered into FLEX SOM (just like they cannot be entered into standard SOM today). Since an order with the capacity of Firm can be valid for a solicitation order, the Exchange will not System enforce the rejection of Firm capacity orders to avoid the rejection of contra-side orders that are entered with a Firm capacity and are, in fact, solicitations at the outset. Instead, it will monitor for compliance with the requirement that the contra-side order be a solicitation rather than a facilitation through surveillance, as it does today for non-FLEX SOM. The applicable rule for the foregoing requirement will be set forth in Supplementary Material .02 to Options 3A, Section 13.

¹⁶⁶ See Cboe Rule 5.74(a)(2) for similar provisions, except the Exchange will add a similar stipulation for each leg of a complex FLEX Order for clarity.

¹⁶⁷ See Cboe Rule 5.74(a)(4) for similar provisions except unlike Cboe, the Exchange will not allow the Solicited Order to be comprised of multiple solicited orders in FLEX SOM to be consistent with current non-FLEX SOM functionality in Options 3,

• **Minimum Increment.** The price of the Agency Order and Solicited Order for simple FLEX Orders must be in an increment the Exchange determines on a class basis (which may not be smaller than the amounts set forth in Section 5 above). If the Agency Order and Solicited Order are complex orders, the price must be a net price for the complex strategy.¹⁶⁸ While the Exchange will align to Cboe's minimum increment requirements (*i.e.*, \$0.01) for the individual options legs of a complex FLEX Order entered into a FLEX SOM, the Exchange also proposes to align the minimum increment requirements for stock-tied FLEX complex strategies with the existing requirements for stock-tied non-FLEX complex strategies as set forth in Options 3, Section 14(c)(1). As such, proposed Options 3A, Section 12(a)(5) will further provide that the prices of Complex Options Strategies (as defined in Options 3, Section 14) may be expressed in one cent (\$0.01) increments, and the options leg of Complex Options Strategies may be executed in no smaller than one cent (\$0.01) increments, regardless of the minimum increments otherwise applicable to the individual options legs of the order. Prices of Stock-Option Strategies or Stock-Complex Strategies (each as defined in Options 3, Section 14) may be expressed in any decimal price determined by the Exchange,¹⁶⁹ and the stock leg of a Stock-Option Strategy or Stock-Complex Strategy may be executed in any decimal price permitted in the equity market. The options leg of a Stock-Option Strategy or Stock-Complex Strategy may be executed in no smaller than one cent (\$0.01) increments, regardless of the minimum increments otherwise applicable to the individual options legs of the order. Similar to stock-tied complex orders today, the Exchange believes that smaller minimum

Section 11(d). In addition, the Exchange will not incorporate Cboe's provisions relating to mini options or Micro FLEX Index Options into proposed Section 13(a)(4) as the Exchange does not list these products today. Further, the Exchange is adding a minor clarification that the minimum size requirement will apply to each leg of a complex FLEX Order.

¹⁶⁸ The Exchange notes that unlike Cboe, it will not allow prices to be entered as a percentage value, and therefore will not incorporate the applicable language from Cboe Rule 5.74(a)(5) into proposed Section 13(a)(5). As discussed above, the Exchange will also incorporate existing minimum increment requirements for non-FLEX complex orders into proposed Section 13(a)(5) to align the proposed FLEX functionality with non-FLEX functionality.

¹⁶⁹ The prices for FLEX Stock-Option Strategies and FLEX Stock-Complex Strategies can be expressed to four decimal places, which is identical to how the stock portion of a non-FLEX Stock-Option Strategy and a non-FLEX Stock-Complex Strategy can be priced today. *See supra* note 101.

increments are appropriate for complex FLEX Orders that contain a stock component as the stock component can trade at finer decimal increments permitted by the equity market.

• An Initiating Member may only submit an Agency Order to a FLEX SOM auction after trading in FLEX Options is open pursuant to proposed Section 8.

The System will reject or cancel both an Agency Order and Solicited Order submitted to a FLEX SOM auction that do not meet the conditions in proposed paragraph (a) as described above.

Pursuant to proposed Section 13(b), the Solicited Order must stop the entire Agency Order at a specified price. If the Agency Order and Solicited Order are complex orders, the price must be a net price for the complex strategy. The Initiating Member must specify a single price at which it seeks to execute the Agency Order against the Solicited Order. Otherwise, the System will reject or cancel both an Agency Order and Solicited Order submitted to a FLEX SOM auction that do not meet this condition.¹⁷⁰

Proposed Section 13(c) will govern the FLEX SOM auction process. Specifically, upon receipt of an Agency Order that meets the conditions in paragraphs (a) and (b) as described above, the FLEX SOM auction process commences. Proposed subparagraphs (c)(1)(A) and (B) will describe concurrent FLEX SOM auctions for simple Agency Orders and complex Agency Orders, respectively, and will be materially identical to Cboe Rule 5.74(c)(1)(A) and (B).

One or more FLEX SOM auctions in the same FLEX Option series or same complex strategy (as applicable) may occur at the same time.¹⁷¹ To the extent there is more than one FLEX SOM auction in a FLEX Option series or complex strategy (as applicable) underway at the same time, the FLEX SOM auctions will conclude sequentially based on the times at which the FLEX SOM auction periods end. At the time each FLEX SOM auction concludes, the System allocates the Agency Order pursuant to proposed paragraph (e) as described below, and takes into account all FLEX SOM

¹⁷⁰ *See* Cboe Rule 5.74(b) for similar provisions, except the Exchange will not allow prices to be entered as a percentage value, and therefore will not incorporate the applicable language from Cboe's rule into proposed Section 13(b).

¹⁷¹ Further, for complex Agency Orders, SOM auctions in different complex strategies may be ongoing at any given time, even if the complex strategies have overlapping components. A FLEX SOM auction in a complex strategy may be ongoing at the same time as a FLEX SOM auction in any component of the complex strategy. *See* proposed subparagraph (c)(1)(B)(i) of Options 3A, Section 13.

responses received during the FLEX SOM auction period. As noted above, the proposed concurrent FLEX SOM auction feature is consistent with Cboe's concurrent FLEX SAM auctions feature in Cboe Rule 5.74(c)(1), and is also consistent with the concurrent auction feature proposed above for FLEX Auctions and FLEX PIM. For the same reasons stated above for FLEX Auctions and FLEX PIM, the Exchange believes that providing this concurrent auction functionality for FLEX SOM may provide additional opportunities for execution of FLEX Orders by encouraging Members to use FLEX SOM.

Pursuant to proposed Section 13(c)(2), the System initiates the FLEX SOM auction process by sending a FLEX SOM auction notification message detailing the side, size, price, capacity, auction ID, the length of the FLEX SOM auction period, and FLEX Option series or complex strategy, as applicable, of the Agency Order to all Members that elect to receive FLEX SOM auction notification messages. Similar to all other auction notifications, FLEX SOM auction notification messages will not be disseminated to OPRA. These provisions are materially identical to Cboe Rule 5.74(c)(2).

Proposed Section 13(c)(3) will describe the "FLEX SOM Auction period," and is based on Cboe Rule 5.74(c)(3). The FLEX SOM Auction period will be defined as a period of time that must be designated by the Initiating Member, which may be no less than three seconds and no more than five minutes. Similar to the exposure interval for electronic FLEX Auctions in Section 11(b) and the FLEX PIM Auction period in Section 12(c)(3) as discussed above, the Initiating Member will be required to identify a length of time within the specified parameters for FLEX SOM as there will be no default for the FLEX SOM Auction period. Otherwise, their FLEX Order will be rejected by the System. Further, if the designated length of the FLEX SOM Auction period exceeds the market close, then the auction will end at the market close with an execution, if an execution is permitted by this Section 13. Cboe's rule does not specify whether an execution (if permitted) would occur if the designated length exceeds the market close. However, the Exchange's non-FLEX auctions currently allow executions (as permitted by their respective rules) to occur in such scenarios, so the Exchange proposes to be consistent with current

System functionality in this regard.¹⁷² In doing so, the Exchange's proposal will promote executions in FLEX SOM (instead of cancelling the FLEX Order) while also preventing executions from occurring after the market close.

Proposed Section 13(c)(4) will provide that an Initiating Member may not modify an Agency Order or Solicited Order after submission to a FLEX SOM auction. This will be similar to Cboe Rule 5.74(c)(4) except unlike Cboe, the Exchange will allow Initiating Members to cancel their Agency Orders and Solicited Orders upon submission into a FLEX SOM, which will align with current SOM functionality.¹⁷³

Proposed Section 13(c)(5) will govern the requirements for FLEX SOM responses. Specifically:

- Any Member other than the Initiating Member (the response cannot have the same badge/mnemonic as the Agency Order) may submit responses to a FLEX SOM auction that are properly marked specifying size, side, price, and the auction ID for the FLEX SOM auction to which the Member is submitting the response. A FLEX SOM response may only participate in the FLEX SOM auction with the auction ID specified in the response.¹⁷⁴

- The minimum price increment for FLEX SOM responses is the same as the one the Exchange determines for a class pursuant to proposed Section 12(a)(5) above. A response to a FLEX SOM auction of a complex Agency Order must have a net price. The System will reject a FLEX SOM response that is not in the applicable minimum increment.¹⁷⁵

- A Member using the same badge/mnemonic may only submit a single FLEX SOM response per auction ID for a given auction. If an additional SOM response is submitted for the same auction ID from the same badge/mnemonic, then that FLEX SOM response will automatically replace the previous FLEX SOM response.¹⁷⁶

¹⁷² While this behavior is not explicitly stated in the current Rules, the Exchange's proposal will be consistent with current non-FLEX auction behavior, including current PIM and SOM behavior.

¹⁷³ This feature is not explicitly stated in the current SOM rules in Options 3, Section 11(d), but it is consistent with current SOM functionality.

¹⁷⁴ See proposed Options 3A, Section 13(c)(5), which is based on Cboe Rule 5.74(c)(5).

¹⁷⁵ See proposed Options 3A, Section 13(c)(5)(A), which is based on Cboe Rule 5.74(c)(5)(A) except the Exchange will not allow prices to be expressed as a percentage value.

¹⁷⁶ See proposed Options 3A, Section 13(c)(5)(B), which will be different from Cboe Rule 5.74(c)(5)(B) because the Exchange will not allow Members to submit multiple FLEX SOM responses using the same badge/mnemonic, and will not aggregate all of the Member's FLEX SOM responses. While the Exchange's standard non-FLEX rules are currently

- The System will cap the size of a FLEX SOM response at the size of the Agency Order (*i.e.*, the System will ignore size in excess of the size of the Agency Order when processing the FLEX SOM auction).¹⁷⁷

- FLEX SOM responses must be on the opposite side of the market as the Agency Order. The System rejects a FLEX SOM response on the same side of the market as the Agency Order.¹⁷⁸

- FLEX SOM responses will not be visible to FLEX SOM auction participants or disseminated to OPRA.¹⁷⁹

- A Member may modify or cancel its FLEX SOM responses during a FLEX SOM auction.¹⁸⁰

Pursuant to proposed Section 13(d), a FLEX SOM auction concludes at the earliest to occur of the following times: (1) the end of the FLEX SOM auction period; and (2) any time the Exchange halts trading in the affected underlying, provided, however, that in such instance the FLEX SOM auction concludes without execution.¹⁸¹

Proposed Section 13(e) will govern how executions will occur in FLEX SOM. In particular, at the end of the FLEX SOM auction, the System will execute the Agency Order against the Solicited Order or FLEX SOM responses at the best price(s) as follows. For purposes of ranking the Solicited Order and FLEX SOM responses when determining how to allocate the Agency Order against the Solicited Order and those responses, the term "price" refers to the dollar and decimal amount of the order or response bid or offer.¹⁸²

silent in this regard, the Exchange is making these concepts clear in the proposed FLEX language. Ultimately the Exchange's proposed FLEX SOM functionality in this regard will align to current non-FLEX auction functionality, including SOM auctions in Options 3, Section 11(d).

¹⁷⁷ See proposed Options 3A, Section 13(c)(5)(C), which is based on Cboe Rule 5.74(c)(5)(C) except the Exchange will not allow Members to submit multiple FLEX SOM responses using the same badge/mnemonic, and will not aggregate all of the Member's FLEX SOM responses. As noted above, this will align to current non-FLEX auction functionality, including SOM auctions in Options 3, Section 11(d).

¹⁷⁸ See proposed Options 3A, Section 13(c)(5)(D), which is materially identical to Cboe Rule 5.74(c)(5)(D).

¹⁷⁹ See proposed Options 3A, Section 13(c)(5)(E), which is materially identical to Cboe Rule 5.74(c)(5)(E).

¹⁸⁰ See proposed Options 3A, Section 13(c)(5)(F), which is materially identical to Cboe Rule 5.74(c)(5)(F).

¹⁸¹ See Cboe Rule 5.74(d) for similar provisions, except the Exchange will make a minor clarification that this rule applies when the Exchange halts trading in the affected *underlying* (and not series, which is what Cboe currently has in its rule).

¹⁸² See Cboe Rule 5.74(e) for similar provisions except the Exchange will not allow prices to be expressed as a percentage value.

Proposed subparagraphs (e)(1)–(3) detail the FLEX SOM allocation methodology for the following scenarios:

- *Execution Against Solicited Order:* The System executes the Agency Order against the Solicited Order at the stop price if there are no Priority Customer FLEX SOM responses and the aggregate size of FLEX SOM responses at an improved price(s) is insufficient to satisfy the Agency Order.¹⁸³

- *Execution Against FLEX SOM Responses:* The System executes the Agency Order against FLEX SOM responses if (1) there is a Priority Customer FLEX SOM response and the aggregate size of that response and all other FLEX SOM responses is sufficient to satisfy the Agency Order or (2) the aggregate size of FLEX SOM responses at an improved price(s) is sufficient to satisfy the Agency Order. The Agency Order executes against FLEX SOM responses at each price level. At the price at which the balance of the Agency Order can be fully executed, in the following order:

- Priority Customer FLEX SOM responses (in time priority);¹⁸⁴ and
- All other FLEX SOM responses, allocated on a Size Pro-Rata basis (as defined in Options 3, Section 10(c)).¹⁸⁵

- *No Execution:* The System will cancel the Agency Order and Solicited Order with no execution if there is a Priority Customer FLEX SOM response and the aggregate size of that response and other FLEX SOM responses is insufficient to satisfy the Agency Order.¹⁸⁶

Pursuant to proposed Section 12(e)(4), the System cancels any unexecuted FLEX SOM responses (or unexecuted portions) at the conclusion of a FLEX SOM auction.¹⁸⁷

Lastly, the Exchange proposes a number of policies applicable to FLEX SOM as Supplementary Materials to Options 3A, Section 13. Specifically, proposed Supplementary Material .01 will provide that prior to entering Agency Orders into a FLEX SOM auction on behalf of customers, Initiating Members must deliver to the customer a written notification informing the customer that its order

¹⁸³ See proposed Section 13(e)(1), which is materially identical to Cboe Rule 5.74(e)(1).

¹⁸⁴ See proposed Section 13(e)(2)(A), which is materially identical to Cboe Rule 5.74(e)(2)(A).

¹⁸⁵ See proposed Section 13(e)(2)(B), which is materially identical to Cboe Rule 5.74(e)(2)(B). The Exchange notes that Size Pro-Rata (as defined in Options 3, Section 10(c)) is similar to pro-rata as referenced in the Cboe rule (and as defined in Cboe Rule 5.32(a)(1)(B)).

¹⁸⁶ See proposed Section 13(e)(3), which is materially identical to Cboe Rule 5.74(e)(3).

¹⁸⁷ See Cboe Rule 5.74(e)(4) for substantially similar provisions.

may be executed using the FLEX SOM Auction. The written notification must disclose the terms and conditions contained in this Rule and be in a form approved by the Exchange.¹⁸⁸ Proposed Supplementary Material .02 will provide that under this Rule, Initiating Members may enter contra-side orders that are solicited. FLEX SOM provides a facility for Members that locate liquidity for their customer orders. Members may not use the FLEX SOM auction to circumvent Options 3, Section 22(b) limiting principal transactions. This may include, but is not limited to, Members entering contra-side orders that are solicited from (1) affiliated broker-dealers, or (2) broker-dealers with which the Member has an arrangement that allows the Member to realize similar economic benefits from the solicited transaction as it would achieve by executing the customer order in whole or in part as principal. Additionally, any solicited contra-side orders entered by Members to trade against Agency Orders may not be for the account of an Exchange Market Maker that is assigned to the options class.¹⁸⁹ Lastly, proposed Supplementary Material .03 will provide that if an allocation would result in less than one contract, then one contract will be allocated.¹⁹⁰ This aligns to how the Exchange currently allocates contracts in SOM.¹⁹¹

O. Risk Protections (Section 14)

The Exchange proposes in Options 3A, Section 14 to specify which of the Exchange's risk protections apply to FLEX trading. Risk protections are protections in our System to help minimize risk. The risk protections specified in proposed Options 3A, Sections 14(a) and 14(b) are mandatory whereas the risk protections specified in proposed Options 3A, Section 14(c) are optional. Proposed Section 14(a) will

¹⁸⁸ See Cboe Rule 5.74, Interpretations and Policies .01 for materially identical provisions.

¹⁸⁹ See Cboe Rule 5.74, Interpretations and Policies .02 for similar provisions. The Exchange is also adding a prohibition against solicited contra-side orders being for the account of an Exchange Market Maker assigned to the options class to align with the current prohibition in Supplementary Material .03 to Options 3, Section 11.

¹⁹⁰ The Exchange notes that it is not proposing to add the provision from Cboe Rule 5.74, Interpretations and Policies .03 that states: "A FLEX Official may nullify a transaction following a FLEX SAM Auction pursuant to Rule 5.75(b)." Because the FLEX Official is a floor concept and the Exchange does not operate a trading floor, the Exchange will not incorporate this concept into its proposed FLEX rules. Instead, the Exchange will System-enforce this provision by rejecting a FLEX SAM auction that does not comply with the provisions in proposed Options 3A, Section 13.

¹⁹¹ See Supplementary Material .09 to Options 3, Section 11.

provide that the following simple order risk protections (as described in Options 3, Section 15) are available to FLEX Options: Market Wide Risk Protection and Size Limitation.¹⁹² As set forth in Options 3, Section 15(a)(1)(C), Market Wide Risk Protections are mandatory activity-based protections that allow Members to establish limits for order entry and execution rate during a specified period of time. The System maintains separate counts for each of the thresholds specified in the rule over rolling periods of time.¹⁹³ Upon triggering the specified limits, the System will either delete all open orders and prevent entry of new orders for the Member, or prevent entry of new orders for the Member. Similar to how Market Wide Risk Protection assists Members in better managing their risk in the standard non-FLEX market on ISE today, the Exchange believes that applying Market Wide Risk Protection to its FLEX market will be beneficial for Members using FLEX trading.

Proposed Section 14(b) will provide that the following complex order risk protections (as described in Options 3, Section 16) are available to FLEX Options: Strategy Protections (only to FLEX Auctions and FLEX responses in proposed Options 3A, Section 11(b)), Size Limitation,¹⁹⁴ the Price Limit for

¹⁹² Size Limitation for simple orders is a limit on the number of contracts an incoming order may specify. Orders that exceed the maximum number of contracts are rejected. The maximum number of contracts, which shall not be less than 10,000, is established by the Exchange from time-to-time. See Options 3, Section 15(a)(2)(B).

¹⁹³ As set out in Options 3, Section 15(a)(1)(C), the Market Wide Risk Protection will have counting programs that will maintain separate counts, over rolling time periods specified by the Member for each count, of: (1) the total number of orders entered in the regular order book; (2) the total number of orders entered in the complex order book with only options legs; (3) the total number of Stock-Option and Stock-Complex Orders; (4) the total number of contracts traded in regular orders; (5) the total number of contracts traded in Complex Options Orders; and (6) the total number of contracts traded in Stock-Option and Stock-Complex Orders. As applied to FLEX, only items (4) through (6) of the foregoing will apply. Items (1) through (3) will not apply to FLEX because there is no order book for FLEX. The Exchange notes that Options 3, Section 15(a)(1)(C)(5) (*i.e.*, item (5) of the foregoing) presently refers to Stock-Option and Stock Complex Orders, instead of Complex Options Orders. However, ISE will file a clean-up amendment so that subparagraph (5) will refer instead to Complex Options Orders. This clean-up will align ISE's rule to MRX Options 3, Section 15(a)(1)(C).

¹⁹⁴ Size Limitation for complex orders is a limit on the number of contracts (and shares in the case of a Stock-Option Strategy or Stock-Complex Strategy) any single leg of an incoming Complex Order may specify. Orders that exceed the maximum number of contracts (or shares) are rejected. The maximum number of contracts (or shares), which shall not be less than 10,000 (or 100,000 shares), is established by the Exchange from time-to-time. See Options 3, Section 16 (c)(2).

Complex Order protections as applicable to the stock component (as described in Options 3, Section 16(a)),¹⁹⁵ the Stock-Tied NBBO protections (as described in Options 3, Section 16(d)),¹⁹⁶ and the Stock-Tied Reg SHO protections (as described in Options 3, Section 16(e)).¹⁹⁷

The Strategy Protections listed in Options 3, Section 16(b) are the Vertical Spread Protection,¹⁹⁸ Calendar Spread Protection,¹⁹⁹ Butterfly Spread Protection,²⁰⁰ and Box Spread Protection.²⁰¹ These Strategy Protections are all aimed at preventing the potential execution of the specified complex strategies (*i.e.*, vertical spread, calendar spread, butterfly spread, and box spread) outside of specified price parameters in order to prevent executions at undesirable prices. Today, Strategy Protections do not apply to

¹⁹⁵ The Exchange amended the Price Limits for Complex Order protections in Options 3, Section 16(a) for its standard non-FLEX complex market as part of the technology migration to enhanced Nasdaq functionality discussed above. See supra note 11. See also Securities Exchange Act Release No. 98066 (August 7, 2023), 88 FR 54672 (August 11, 2023) (SR-ISE-2023-13).

¹⁹⁶ The Exchange introduced the Stock-Tied NBBO protections in Options 3, Section 16(d) for its standard non-FLEX complex market as part of the technology migration to enhanced Nasdaq functionality discussed above. See supra note 11. See also Securities Exchange Act Release No. 98066 (August 7, 2023), 88 FR 54672 (August 11, 2023) (SR-ISE-2023-13).

¹⁹⁷ The Exchange introduced the Stock-Tied Reg SHO protections in Options 3, Section 16(e) for its standard non-FLEX complex market as part of the technology migration to enhanced Nasdaq functionality discussed above. See supra note 11. See also Securities Exchange Act Release No. 98066 (August 7, 2023), 88 FR 54672 (August 11, 2023) (SR-ISE-2023-13).

¹⁹⁸ The Vertical Spread Protection will apply to a vertical spread. A vertical spread is an order to buy a call (put) option and to sell another call (put) option in the same security with the same expiration but at a higher (lower) strike price. See Options 3, Section 16(b)(1).

¹⁹⁹ The Calendar Spread Protection will apply to a Calendar Spread. A calendar spread is an order to buy a call (put) option with a longer expiration and to sell another call (put) option with a shorter expiration in the same security at the same strike price. See Options 3, Section 16(b)(2).

²⁰⁰ The Butterfly Spread Protection will apply to a butterfly spread. A butterfly spread is a three legged Complex Order with the following: (1) two legs to buy (sell) the same number of calls (puts); (2) one leg to sell (buy) twice the number of calls (puts) with a strike price at mid-point of the two legs to buy (sell); (3) all legs have the same expiration; and (4) each leg strike price is equidistant from the next sequential strike price. See Options 3, Section 16(b)(3).

²⁰¹ The Box Spread Protection will apply to a box spread. A box spread is a four legged Complex Order with the following: (1) one pair of legs with the same strike price with one leg to buy a call (put) and one leg to sell a put (call); (2) a second pair of legs with a different strike price from the pair described in (1) with one leg to sell a call (put) and one leg to buy a put (call); (3) all legs have the same expiration; and (4) all legs have equal volume. See Options 3, Section 16(b)(4).

orders and responses submitted into non-FLEX PIM and non-FLEX SOM.²⁰² The Exchange will align this application to FLEX such that Strategy Protections would only apply to FLEX Auctions and FLEX responses in proposed Section 11(b) as described above, and not to FLEX Orders and responses submitted into FLEX PIM and FLEX SOM.

As noted above, the Exchange adopted the Price Limit for Complex Order protections in Options 3, Section 16(a),²⁰³ the Stock-Tied NBBO protections in Options 3, Section 16(b),²⁰⁴ and the Stock-Tied Reg SHO protections in Options 3, Section 16(e)²⁰⁵ (collectively, the “Stock-Tied

²⁰² See Options 3, Section 16(b), which describes the non-applicability of the Strategy Protections to certain auction mechanisms. See also Securities Exchange Act Release No. 100743 (August 16, 2024), 89 FR 68014 (August 22, 2024) (SR-ISE-2024-39) (effective but not yet operative). As amended by SR-ISE-2024-39, Options 3, Section 16(b) would provide that the Strategy Protections will not apply when a standard non-FLEX complex order includes at least one p.m.-settled leg and at least one a.m.-settled leg. This would likewise be true for complex FLEX Orders (*i.e.*, the Strategy Protections would not apply when a complex FLEX Order includes at least one p.m.-settled leg and at least one a.m.-settled leg).

²⁰³ Specifically, Options 3, Section 16(a) states that as provided in Options 3, Section 14(d)(2), the legs of a complex strategy may be executed at prices that are inferior to the prices available on other exchanges trading the same options series. Notwithstanding, the System will not permit any leg of a complex strategy to trade through the NBBO for the series or any stock component by a configurable amount calculated as the lesser of (i) an absolute amount not to exceed \$0.10, and (ii) a percentage of the NBBO not to exceed 500%, as determined by the Exchange on a class, series or underlying basis. A Member can also include an instruction on a Complex Order that each leg of the Complex Order is to be executed only at a price that is equal to or better than the NBBO for the options series or any stock component, as applicable (“Do-Not-Trade-Through” or “DNTT”). As discussed later in this filing, the NBBO price limit for the option series will not apply to complex FLEX orders; however, the NBBO price limit for the stock component will apply.

²⁰⁴ Specifically, Options 3, Section 16(d) provides that for Complex Orders in Stock-Option Strategies and Stock-Complex Strategies, the Exchange shall electronically communicate the underlying security component of a Complex Order to Nasdaq Execution Services, LLC (“NES”), its designated broker dealer, for immediate execution. Such execution and reporting will not occur on the Exchange and will be handled by NES pursuant to applicable rules regarding equity trading. NES will ensure that the execution price is within the high-low range for the day in that stock at the time the Complex Order is processed and within a certain price from the current market pursuant to Options 3, Section 16(a). If the stock price is not within these parameters, the Complex Order is not executable and the Exchange will hold the Complex Order on the Order Book, if consistent with Member instructions. This risk protection will apply wholesale to complex FLEX Orders with a stock component.

²⁰⁵ Specifically, Options 3, Section 16(e) provides that when the short sale price test in Rule 201 of Regulation SHO is triggered for a covered security, NES will not execute a short sale order in the underlying covered security component of a

Risk Protections”) as part of SR-ISE-2023-13 for its standard non-FLEX complex market. The Exchange is now proposing to apply the Stock-Tied Risk Protections to complex FLEX Orders to the extent the complex FLEX Order has a stock component. The Price Limits for Complex Orders in Options 3, Section 16(a) seek to prevent complex executions from occurring outside of certain price limits that are tied to the NBBO for the options series or for any stock component. Because there will be no book for FLEX trading (and therefore no NBBO for the FLEX Options series), the Exchange will not apply the price limit protection tied to the NBBO for the options series for FLEX trading. To the extent the complex FLEX Order has a stock component, the Exchange will only apply the price limit protection tied to the NBBO for the stock component. The below is an example of how the Exchange will apply the Options 3, Section 16(a) price protection to complex FLEX Orders.

Scenario illustrating applicability of the stock buffer described in Options 3, Section 16(a) Price Limits for Complex Orders:

IBM Underlying/Stock NBBO is 1.00 × 2.00

Stock buffer is configured to the lesser of \$0.05 or 5%

FLEX Option NBBO does not exist, but the minimum trading increment/minimum price variation (MPV) for option leg executions is \$0.01

- *FLEX Auction is entered in a Stock-Complex Strategy encompassing 2 IBM FLEX Put options: Buy 1 Put (FLEX option leg A) + Buy 1 Put (FLEX option leg B) + Buy 100 shares IBM stock: Buy 110 units of the A + B + Stock strategy @net price of \$1.02.*

- *A firm responds to Sell 110 @net price of \$0.89.*

FLEX Auction timer passes & auction concludes

- *The firm’s response trades with the FLEX Auction order 110 @net price of \$0.97 because the stock component*

Complex Order if the price is equal to or below the current national best bid. However, NES will execute a short sale order in the underlying covered security component of a Complex Order if such order is marked “short exempt,” regardless of whether it is at a price that is equal to or below the current national best bid. If NES cannot execute the underlying covered security component of a Complex Order in accordance with Rule 201 of Regulation SHO, the Exchange will hold the Complex Order on the Complex Order Book, if consistent with Member instructions. The order may execute at a price that is not equal to or below the current national best bid. For purposes of this paragraph, the term “covered security” shall have the same meaning as in Rule 201(a)(1) of Regulation SHO. This risk protection will apply wholesale to complex FLEX Orders with a stock component.

cannot trade at any price lower than \$0.95 (\$1.00 – \$0.05 [price limit for stock component] = \$0.95) and the FLEX option legs cannot trade at any price lower than \$0.01 as this is the minimum trading increment for option legs; therefore, the minimum stock price of \$0.95 plus the \$0.01 minimum option leg price means that, despite the \$0.89 limit price on the response, the strategy cannot trade below \$0.97 (\$0.95 + [\$0.01*2 legs]).

As it relates to the other Stock-Tied Risk Protections (*i.e.*, the Stock-Tied NBBO protections and the Stock-Tied Reg SHO protections), these will apply wholesale to complex FLEX Orders with a stock component as noted above.

Proposed Section 14(c) will provide that the optional risk protections in Options 3, Section 28 are available to FLEX Options.²⁰⁶ In particular, the following are optional risk protections in Options 3, Section 28: (1) notional dollar value per order (which will be calculated as quantity multiplied by limit price multiplied by number of underlying shares), (2) daily aggregate notional dollar value, (3) quantity per order, and (4) daily aggregate quantity. In sum, Members may set thresholds for each of the foregoing protections in order to limit the quantity and notional value they can send per order and on aggregate for the day.

P. Data Feeds (Section 15)

The Exchange proposes to specify in Options 3A, Section 15 which data feeds it will disseminate auction notifications for simple and complex FLEX Orders. Proposed Section 15(a) will provide that auction notifications for simple FLEX Orders will be disseminated through the Order Feed, as described in Options 3, Section 23(a)(2).²⁰⁷ Proposed Section 15(b) will provide that auction notifications for complex FLEX Orders will be disseminated through the Spread Feed, as described in Options 3, Section

²⁰⁶ The Exchange introduced the optional risk protections in Options 3, Section 28 as part of the technology migration to enhanced Nasdaq functionality discussed above. See Securities Exchange Act Release No. 96818 (February 6, 2023), 88 FR 8950 (February 10, 2023) (SR-ISE-2023-06).

²⁰⁷ The Nasdaq ISE Order Feed (“Order Feed”) provides information on new orders resting on the book (*e.g.* price, quantity and market participant capacity). In addition, the feed also announces all auctions. The data provided for each option series includes the symbols (series and underlying security), put or call indicator, expiration date, the strike price of the series, and whether the option series is available for trading on ISE and identifies if the series is available for closing transactions only. The feed also provides order imbalances on opening/reopening.

23(a)(5).²⁰⁸ The Exchange notes that this aligns to current functionality where simple auction notifications are disseminated over the Order Feed and complex auction notifications are disseminated over the Spread Feed. Today, simple and complex auction notifications inform Members that an auction order has been accepted by the System and that an auction is commencing. Auction notifications also contain all of the relevant information Members need to respond to that particular auction.²⁰⁹ As proposed, the simple and complex FLEX auction notifications will likewise inform Members that a FLEX auction order has been accepted by the System, a FLEX auction is commencing, and will also contain all of the relevant information Members need to respond to that particular FLEX auction.²¹⁰ The FLEX auction notifications will specify that a particular auction is FLEX versus non-FLEX. As is the case today for non-FLEX auctions, FLEX auction notifications disseminated over the Order Feed and the Spread Feed will be available to all Members that elect to receive such notification messages.

Q. FLEX Market Makers (Section 16)

Proposed Section 16 will govern FLEX Market Makers on the Exchange.

²⁰⁸ Nasdaq ISE Spread Feed ("Spread Feed") is a feed that consists of: (1) options orders for all Complex Orders (*i.e.*, spreads, buy-writes, delta neutral strategies, etc.); (2) data aggregated at the top five price levels (BBO) on both the bid and offer side of the market; (3) last trades information. The Spread Feed provides updates, including prices, side, size and capacity, for every Complex Order placed on the ISE Complex Order book. The Spread Feed shows: (1) aggregate bid/ask quote size; (2) aggregate bid/ask quote size for Professional Customer Orders; and (3) aggregate bid/ask quote size for Priority Customer Orders for ISE traded options. The feed also provides Complex Order auction notifications. The Exchange notes that as applied to FLEX, the majority of the data elements in the Spread Feed will not apply to FLEX Options (*e.g.*, data aggregated at the top five price levels (BBO) on both the bid and offer side of the market and aggregate bid/ask quote size). While other data elements (*e.g.*, options orders for all Complex Orders and last trades information) also apply to FLEX, the Exchange is pointing out auction notifications in the proposed rule to be transparent about the most salient feature for complex FLEX Orders.

²⁰⁹ For example, at the commencement of a standard, non-FLEX PIM auction, the Exchange sends a broadcast message (*i.e.*, auction notification) that includes the series, price and size of the Agency Order, and whether it is to buy or sell, through the Order Feed. *See* Options 3, Section 13(c).

²¹⁰ For example, at the commencement of a FLEX PIM Auction, the Exchange would send FLEX PIM Auction notification message detailing the side, size, auction ID, the length of the FLEX PIM Auction period, and FLEX Option series or complex strategy, as applicable, of the Agency Order to all Members that elect to receive FLEX PIM Auction notification messages. *See* proposed Options 3A, Section 12(c)(2).

Pursuant to proposed Section 16(a), a FLEX Market Maker will automatically receive an appointment in the same FLEX option class(es) as its non-FLEX class appointments selected pursuant to Options 2, Section 3.²¹¹ Only the Primary Market Maker in the non-FLEX Option may be the assigned Primary Market Maker in that FLEX Option.²¹² Today, in order for Market Makers to submit auction responses in option classes through SQF, they need to be appointed to that option class.²¹³ As such, the Exchange is automatically carrying over the FLEX Market Maker's non-FLEX options class appointment as its FLEX option class appointment in order to allow the FLEX Market Maker to respond to the electronic FLEX Auction, FLEX PIM, and FLEX SOM as described above.

Proposed Section 16(b) will provide that each FLEX Market Maker must fulfill all the obligations of a Market Maker under Options 2 and must comply with the applicable provisions, except FLEX Market Makers do not need to provide continuous quotes in FLEX Options.²¹⁴

R. Letters of Guarantee (Section 17)

The Exchange proposes in Options 3A, Section 17(a) to provide that no FLEX Market Maker shall effect any transaction in FLEX Options unless one or more effective Letter(s) of Guarantee has been issued by a Clearing Member and filed with the Exchange accepting financial responsibility for all FLEX transactions made by the FLEX Market Maker pursuant to Options 6, Section 4.²¹⁵

²¹¹ *See* Cboe Rule 3.58(c) for materially identical provisions.

²¹² The Exchange notes that this requirement is based on Phlx Options 8, Section 34(d)(1), which currently states that only the Lead Market Maker in the non-FLEX option may be the assigned Specialist in that FLEX option. Primary Market Maker on ISE is analogous to a Lead Market Maker on Phlx.

²¹³ *See supra* note 68 describing SQF features available in the Exchange's non-FLEX market today (including the ability for Market Makers to currently send auction responses). As discussed above, the Exchange is proposing to also allow FLEX auction responses through SQF.

²¹⁴ *See* Cboe Rule 5.57 for similar provisions related to FLEX Market Makers. The Exchange will not impose continuing quoting obligations on FLEX Market Makers (similar to Cboe) given that such obligations are relevant for book trading. As discussed above, there will be no book trading for FLEX Options. As discussed above, the Exchange will not incorporate provisions related to FLEX Officials like Cboe as this is generally a floor trading concept and the Exchange does not have a trading floor.

²¹⁵ Options 6, Section 4 provides that no Market Maker shall make any transactions on the Exchange unless a Letter of Guarantee has been issued for such Member by a Clearing Member and filed with the Exchange, and unless such Letter of Guarantee has not been revoked pursuant to paragraph (c) of

S. Position Limits (Section 18)

The Exchange proposes to detail the position limits for FLEX Options in Options 3A, Section 18. As discussed below, proposed Section 18 will be based on the FLEX Options position limit rules on Cboe and its own market.

Proposed Section 18(a) will govern the position limits for FLEX Index Options. Specifically, proposed Section 18(a)(1) will provide that except as provided in proposed Section 18(a)(2)–(4) below, FLEX Index Options shall be subject to the same position limits governing index options as provided for in Options 4A, Sections 6 and 7.²¹⁶ Proposed Section 18(a)(2) will provide that except as otherwise provided in subparagraph (a)(3) of this Rule, in no event shall the position limits for broad-based FLEX Index Options exceed 25,000 contracts on the same side of the market.²¹⁷ Proposed Section 18(a)(3) will provide that there shall be no position limits for broad-based index options listed in Options 4A, Section 6(a).²¹⁸ However, each Member (other than FLEX Market Makers) that maintains a FLEX broad-based index option position on the same side of the market in excess of 100,000 contracts in NDX or RUT for its own account or for the account of a customer, shall report information as to whether the positions are hedged and provide documentation as to how such contracts are hedged, in the manner and form required by the Exchange. In calculating the applicable contract-reporting amount, reduced-value contracts will be aggregated with full-value contracts and counted by the amount by which they equal a full-value contract (*e.g.*, 10 MNX options equal 1 NDX full-value contract). The Exchange may impose other reporting requirements as well as the limit at which the reporting requirement may be triggered.²¹⁹ Whenever the Exchange

this Rule. A Letter of Guarantee shall provide that the issuing Clearing Member accepts financial responsibilities for all Exchange Transactions made by the guaranteed Member.

²¹⁶ Options 4A, Sections 6 and 7 presently set forth the position limits for broad-based and industry index options, respectively.

²¹⁷ This separate same side position limit for broad-based FLEX Index Options (except for the ones noted below) is based on the Exchange's same side position limit for its standard market as set forth in Options 4A, Section 6(a).

²¹⁸ As such the following broad-based index options listed in Options 4A, Section 6(a) will have no position limits for FLEX Index Options: options on the Nasdaq 100 Index, Mini Nasdaq 100 Index, Nations VolDex Index, Nasdaq 100 Reduced Value Index, and Nasdaq Micro Index Options.

²¹⁹ *See* Options 4A, Section 9(a)(13) (setting forth the same reporting requirements for the Exchange's standard non-FLEX index options market). *See also* Cboe Rule 8.35(b) for similar reporting requirements.

determines that additional margin is warranted in light of the risks associated with an under-hedged FLEX NDX or RUT options position, the Exchange may impose additional margin upon the account maintaining such under-hedged position pursuant to its authority under Options 6C, Section 5. The clearing firm carrying the account also will be subject to capital charges under Rule 15c3-1 under the Exchange Act to the extent of any margin deficiency resulting from the higher margin requirements.²²⁰

Proposed Section 18(a)(4) will provide that industry-based FLEX Index Options shall be subject to separate position limits of 18,000, 24,000, or 31,500 contracts, depending on the position limit tier determined pursuant to Options 4A, Section 7(a)(1).²²¹

Proposed Section 18(b) will govern the position limits for FLEX Equity Options. Pursuant to proposed Section 18(b)(1)(A), there will generally be no position limits for FLEX Equity Options with the exceptions noted below.²²² Pursuant to proposed Section 18(b)(2), each Member (other than a Market Maker) that maintains a position on the same side of the market in excess of the standard limit under Options 9, Section 13 for non-FLEX Equity Options of the same class on behalf of its own account or for the account of a customer shall report information on the FLEX Equity option position, positions in any related instrument, the purpose or strategy for the position, and the collateral used by the account. This report shall be in the form and manner prescribed by the Exchange.²²³ Pursuant to proposed Section 18(b)(3), whenever the Exchange determines that a higher margin requirement is necessary in light of the risks associated with a FLEX Equity option position in excess of the standard limit for non-FLEX Equity options of the same class, the Exchange may consider imposing additional margin upon the account maintaining such under-hedged position, pursuant to its authority under Options 6C,

²²⁰ See Options 4A, Section 9(a)(14) (setting forth the same stipulation for the Exchange's standard index options market). See also Cboe Rule 8.35(b) for similar stipulations.

²²¹ The proposed position limits align to the Exchange's non-FLEX position limits for industry index options in Options 4A, Section 7(a)(1).

²²² See Cboe Rule 8.35(c)(1)(A) for materially identical provisions. Like Cboe, the Exchange's rule will have exceptions for the aggregation of FLEX positions (proposed Section 18(c)) and for position limits for cash-settled FLEX Equity Options where the underlying security is an ETF (proposed Section 18(b)(1)(B)), which will be discussed later in this filing.

²²³ See Cboe Rule 8.35(c)(2) for materially identical provisions.

Section 5.²²⁴ Additionally, it should be noted that the clearing firm carrying the account will be subject to capital charges under Rule 15c3-1 under the Exchange Act to the extent of any margin deficiency resulting from the higher margin requirement.²²⁵

Proposed Section 18(c) will govern the aggregation of FLEX positions. Specifically, for purposes of the position limits and reporting requirements set forth in this Section 18, FLEX Option positions shall not be aggregated with positions in non-FLEX Options other than as provided in this Section 18(c) and in Section 18(b)(1)(B),²²⁶ and positions in FLEX Index Options on a given index shall not be aggregated with options on any stocks included in the index or with FLEX Index Option positions on another index.²²⁷ Pursuant to proposed Section 18(c)(1), commencing at the close of trading two business days prior to the last trading day of the calendar quarter, positions in P.M.-settled FLEX Index Options (*i.e.*, FLEX Index Options having an exercise settlement value determined by the level of the index at the close of trading on the last trading day before expiration) shall be aggregated with positions in Quarterly Options Series on the same index with the same expiration and shall be subject to the position limits set forth in Options 4A, Section 6 or Section 7, as applicable.²²⁸ Pursuant to proposed Section 18(c)(2), commencing at the close of trading two business days prior to the last trading day of the week, positions in FLEX Index Options that are cash settled²²⁹ shall be aggregated with positions in Short Term Option Series on the same underlying (*e.g.*, same underlying index as a FLEX Index Option) with the same means for determining exercise settlement value (*e.g.*, opening or closing prices of the underlying index) and same expiration, and shall be

²²⁴ Options 6C, Section 5 provides that the amount of margin prescribed by these Rules is the minimum which must be required initially and subsequently maintained with respect to each account affected thereby; but nothing in these Rules shall be construed to prevent a Member from requiring margin in an amount greater than that specified. Further, the Exchange may at any time impose higher margin requirements with respect to such positions when it deems such higher margin requirements to be advisable.

²²⁵ See Cboe Rule 8.35(c)(3) for materially identical provisions.

²²⁶ Proposed Section 18(b)(1)(B) will set forth the position limits for cash-settled FLEX ETF options and will be discussed later in this filing.

²²⁷ See Cboe Rule 8.35(d) for materially identical provisions.

²²⁸ See Cboe Rule 8.35(d)(1) for materially identical provisions.

²²⁹ The Exchange notes that all FLEX Index Options will be cash settled.

subject to the position limits set forth in Options 4A, Section 6 (for broad-based index options) or Section 7 (for narrow-based index options), as applicable.²³⁰ Pursuant to proposed Section 18(c)(3), as long as the options positions remain open, positions in FLEX Options that expire on a third Friday-of-the-month expiration day shall be aggregated with positions in non-FLEX Options on the same underlying, and shall be subject to the position limits set forth in Options 4A, Section 6, Options 4A, Section 7, or Options 9, Section 13, as applicable, and the exercise limits set forth in Options 9, Section 15, as applicable.²³¹

T. Exercise Limits (Section 19)

The Exchange proposes to detail the exercise limits for FLEX Options in Options 3A, Section 19. As discussed below, proposed Section 19 will be based on the FLEX Options exercise limit rules on Cboe and Phlx.

Proposed Section 19(a) will provide that exercise limits for FLEX Options shall be equivalent to the FLEX position limits prescribed in proposed Section 18.²³² There shall be no exercise limits for broad-based FLEX Index Options (including reduced value option contracts) on broad-based index options listed in Options 4A, Section 6(a).²³³

Proposed Section 19(a)(1) will require that the minimum value size for FLEX Equity Option exercises be 25 contracts or the remaining size of the position, whichever is less.²³⁴ Proposed Section 19(a)(2) will require that the minimum value size for FLEX Index Option exercises be \$1 million Underlying Equivalent Value (as defined below) or the remaining Underlying Equivalent Value of the position, whichever is less.²³⁵ Proposed Section 19(a)(3) will stipulate that except as provided in

²³⁰ This is based on Cboe Rule 8.35(d)(2), except the Exchange does not currently list Credit Default Options and will therefore not incorporate the applicable portion into its proposed rule.

²³¹ See Cboe Rule 8.35(d)(3) for materially identical provisions.

²³² Proposed Section 19(a) is based on Cboe Rule 8.42(g) except the Exchange will not incorporate references to Cboe-specific products like Micro FLEX Index Options, FLEX Individual Stock or ETF Based Volatility Index Options. Similarly, the Exchange will replace the references to Cboe-specific broad-based index options like SPX, VIX, etc. with the broad-based index options in Options 4A, Section 6(a), which are similar index products on ISE.

²³³ As such the following broad-based index options listed in Options 4A, Section 6(a) will have no exercise limits for FLEX Index Options: options on the Nasdaq 100 Index, Mini Nasdaq 100 Index, Nations VolDex Index, Nasdaq 100 Reduced Value Index, and Nasdaq Micro Index Options.

²³⁴ See Cboe Rule 8.42(g)(1) for materially identical provisions.

²³⁵ See Cboe Rule 8.42(g)(2) for materially identical provisions.

proposed Section 18(b)(1)(B) and Section 18(c) above,²³⁶ FLEX Options shall not be taken into account when calculating exercise limits for non-FLEX Option contracts.²³⁷ Lastly, proposed Section 19(a)(4) will set forth the definition of Underlying Equivalent Value as the aggregate value of a FLEX Index Option (index multiplier times the current index value) multiplied by the number of FLEX Index Options.²³⁸

U. Capacity and Surveillances

The Exchange has analyzed its capacity and represents that it believes the Exchange and the Options Price Reporting Authority (“OPRA”) have the necessary systems capacity to handle the additional message traffic associated with the listing of new series that may result from the introduction of FLEX Options.²³⁹

Additionally, the Exchange believes it has an adequate surveillance program in place and intends to apply the same program procedures to FLEX Options that is applied to the Exchange’s other options products, as applicable. FLEX Option products and their respective symbols will be integrated into the Exchange’s existing surveillance system architecture and will be subject to the relevant surveillance processes. The Exchange believes that any potential risk of manipulative activity is mitigated by these existing surveillance technologies, procedures, and reporting requirements, which allow the Exchange to properly identify disruptive and/or manipulative trading activity. Additionally, taking into consideration that FLEX Options have unique characteristics, the Exchange has reviewed its catalog of patterns and updated a number of patterns to include FLEX Options transactions for when they begin trading. The Exchange will periodically review its surveillance procedures and make any changes that the Exchange believes are necessary for FLEX trading.

As discussed in more detail in the “Cash-Settled FLEX ETFs” section below, the Exchange is also a member of the Intermarket Surveillance Group

²³⁶ As described above, proposed Section 18(c) will govern the aggregation of FLEX positions generally, while proposed Section 18(b)(1)(B) will govern the aggregation of cash-settled FLEX Equity Options specifically and that positions in such cash-settled FLEX Equity Options will be aggregated with positions in physically settled options on the same underlying ETF. Cash-settled FLEX Equity Options will be discussed later in this filing.

²³⁷ See Cboe Rule 8.42(g)(3) for materially identical provisions.

²³⁸ See Phlx Options 8, Section 34(b)(8)(D) for materially identical provisions.

²³⁹ The Exchange will report FLEX Option trades and, if necessary, trade cancellations to OPRA.

(“ISG”),²⁴⁰ and works with other self-regulatory organizations and exchanges on intermarket surveillance related issues through its participation in the ISG. As discussed in the “Cash-Settled FLEX ETFs” section below, the Exchange and all other ISG members can and do share information for regulatory purposes.

V. Cash-Settled FLEX ETFs

The Exchange proposes to include rule text in proposed Options 3A, Section 3(c) and Section 18, each as discussed above, to allow for cash settlement of certain FLEX Equity Options. Generally, as discussed above, FLEX Equity Options will be settled by physical delivery of the underlying security,²⁴¹ while all FLEX Index Options will be settled by delivery in cash.²⁴² The Exchange proposes to allow FLEX Equity Options where the underlying security is an ETF to be settled by delivery in cash if the underlying security meets prescribed criteria. The Exchange notes that cash-settled FLEX ETF Options will be subject to the same trading rules and procedures described above that will govern the trading of other FLEX Options on the Exchange, with the exception of the rules to accommodate the cash-settlement feature proposed as follows. Today, NYSE American Rule 903G²⁴³ and Cboe Rule 4.21(b)(5)(A)²⁴⁴ allow for cash-settled FLEX ETF Options as well. The Exchange’s proposed rule changes for cash-settled ETF Options will be based on NYSE American Rule 903G and Cboe Rule 4.21(b)(5)(A).

To permit cash settlement of certain FLEX ETF Options, the Exchange

²⁴⁰ ISG is an industry organization formed in 1983 to coordinate intermarket surveillance among the SROs by cooperatively sharing regulatory information pursuant to a written agreement between the parties. The goal of the ISG’s information sharing is to coordinate regulatory efforts to address potential intermarket trading abuses and manipulations.

²⁴¹ See proposed Options 3A, Section 3(c)(5)(A)(i).

²⁴² See proposed Options 3A, Section 3(c)(5)(B). As discussed below, cash settlement is also permitted in the OTC market. Trading in cash-settled FLEX ETF Options will not commence until the related reporting requirements are finalized.

²⁴³ See Securities Exchange Act Release No. 88131 (February 5, 2020), 85 FR 7806 (February 11, 2020) (SR–NYSEAm–2019–38) (Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, To Allow Certain Flexible Equity Options To Be Cash Settled).

²⁴⁴ Cboe also filed an immediately effective rule change to allow certain FLEX Options to be cash settled. See Securities Exchange Act Release No. 98044 (August 2, 2023), 88 FR 53548 (August 8, 2023) (SR–Cboe–2023–036) (Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Allow Certain Flexible Exchange Equity Options To Be Cash Settled).

proposes rule text in Section 3(c)(5)(A)(ii) to provide that the exercise settlement for a FLEX ETF Option may be by physical delivery of the underlying ETF or by delivery in cash if the underlying security, measured over a defined six-month period,²⁴⁵ has an average daily notional value of \$500 million or more and a national average daily volume (“ADV”) of at least 4,680,000 shares.²⁴⁶

The Exchange also proposes in Section 3(c) that a FLEX Equity Option overlying an ETF (cash- or physically-settled) may not be the same type (put or call) and may not have the same exercise style, expiration date, and exercise price as a non-FLEX Equity Option overlying the same ETF.²⁴⁷ In other words, regardless of whether a FLEX Equity Option overlying an ETF is cash or physically settled, at least one of the exercise style (*i.e.*, American-style or European-style), expiration date, and exercise price of that FLEX Option must differ from those terms of a non-FLEX Option overlying the same ETF in order to list such a FLEX Equity Option. For example, suppose a non-FLEX SPY option (which is physically settled, p.m.-settled and American-style) with a specific September expiration and exercise price of 475 is listed for trading. A FLEX Trader could not submit an order to trade a FLEX SPY option that is cash-settled (or physically settled) and American-style with the same September expiration and exercise price of 475.

In addition, the Exchange proposes new subparagraph (a) to Section 3(c)(5)(A)(ii), which would provide that the Exchange will determine bi-annually the underlying ETFs that satisfy the notional value and trading volume requirements in Section 3(c)(5)(A)(ii) by using trading statistics for the defined six-month period.²⁴⁸ The

²⁴⁵ As noted below, the Exchange plans to conduct the bi-annual review on January 1 and July 1 of each year. As such, the six-month periods will be from January to June, and from July to December each year.

²⁴⁶ See Cboe Rule 4.21(b)(5)(A)(ii) for materially identical provisions.

²⁴⁷ See introductory paragraph of Cboe Rule 4.21(b) for materially identical provisions. All non-FLEX Equity Options (including on ETFs) are physically settled. Note all FLEX and non-FLEX Equity Options (including ETFs) are p.m.-settled.

²⁴⁸ See proposed Options 3A, Section 3(c)(5)(A)(ii)(a), which is based on Cboe Rule 4.21(b)(5)(A)(ii)(a). The Exchange plans to conduct the bi-annual review on January 1 and July 1 of each year. As such, the six-month periods will be from January to June, and from July to December each year. The results of the bi-annual review will be announced via an Options Trader Alert and any new securities that qualify would be permitted to have cash settlement as a contract term beginning on February 1 and August 1 of each year. If the Exchange initially begins listing cash-settled FLEX

proposed rule would further provide that the Exchange will permit cash settlement as a contract term on no more than 50 underlying ETFs that meet the criteria in this subparagraph (ii) and that if more than 50 underlying ETFs satisfy the notional value and trading volume requirements, then the Exchange would select the top 50 ETFs that have the highest average daily volume.²⁴⁹

Proposed new subparagraph (b) to Section 3(c)(5)(A)(ii) would further provide that if the Exchange determines pursuant to the bi-annual review that an underlying ETF ceases to satisfy the requirements under proposed Section 3(c)(5)(A)(ii), any new position overlying such ETF entered into will be required to have exercise settlement by physical delivery, and any open cash-settled FLEX ETF Option positions may be traded only to close the position.²⁵⁰

The Exchange believes it is appropriate to introduce cash settlement as an alternative contract term to the select group of ETFs because they are among the most highly liquid and actively traded ETF securities. As described more fully below, the Exchange believes that the deep liquidity and robust trading activity in the ETFs identified by the Exchange as meeting the criteria mitigate against historic concerns regarding susceptibility to manipulation.

Characteristics of ETFs

ETFs are funds that have their value derived from assets owned. The net asset value (“NAV”) of an ETF is a daily calculation that is based off the most recent closing prices of the assets in the fund and an actual accounting of the total cash in the fund at the time of calculation. The NAV of an ETF is calculated by taking the sum of the assets in the fund, including any securities and cash, subtracting out any liabilities, and dividing that by the number of shares outstanding.

Equity Options on a different date (e.g., September 1), it would initially list securities that qualified as of the last bi-annual review (e.g., the one conducted on July 1).

²⁴⁹ See proposed Options 3A, Section 3(c)(5)(A)(ii)(a), which is based on Cboe Rule 4.21(b)(5)(A)(ii)(a).

²⁵⁰ See proposed Section 3(c)(5)(A)(ii)(b), which is based on Cboe Rule 4.21(b)(5)(A)(ii)(b). If a listing is closing only, pursuant to Options 4, Section 4(a), opening transactions by Market Makers executed to accommodate closing transactions of other market participants are permitted.

Additionally, each ETF is subject to a creation and redemption mechanism to ensure the price of the ETF does not fluctuate too far away from its NAV—which mechanisms the Exchange believes reduce the potential for manipulative activity. Each business day, ETFs are required to make publicly available a portfolio composition file that describes the makeup of their creation and redemption “baskets” (i.e., a specific list of names and quantities of securities or other assets designed to track the performance of the portfolio as a whole). ETF shares are created when an Authorized Participant,²⁵¹ typically a market maker or other large institutional investor, deposits the daily creation basket or cash with the ETF issuer. In return for the creation basket or cash (or both), the ETF issues to the Authorized Participant a “creation unit” that consists of a specified number of ETF shares. For instance, IWM is designed to track the performance of the Russell 2000 Index. An Authorized Participant will purchase all the Russell 2000 constituent securities in the exact same weight as the index prescribes, then deliver those shares to the ETF issuer. In exchange, the ETF issuer gives the Authorized Participant a block of equally valued ETF shares, on a one-for-one fair value basis. This process can also work in reverse. A redemption is achieved when the Authorized Participant accumulates a sufficient number of shares of the ETF to constitute a creation unit and then exchanges these ETF shares with the ETF issuer, thereby decreasing the supply of ETF shares in the market.

The principal, and perhaps most important, feature of ETFs is their reliance on an “arbitrage function” performed by market participants that influences the supply and demand of ETF shares and, thus, trading prices relative to NAV. As noted above, new ETF shares can be created and existing shares redeemed based on investor demand; thus, ETF supply is open-ended. This arbitrage function helps to keep an ETF’s price in line with the

²⁵¹ “Authorized Participant” means a member or participant of a clearing agency registered with the Commission, which has a written agreement with the exchange-traded fund or one of its service providers that allows the authorized participant to place orders for the purchase and redemption of creation units. See SEC Rule 6c-11(a)(1).

value of its underlying portfolio, i.e., it minimizes deviation from NAV. Generally, in the Exchange’s view, the higher the liquidity and trading volume of an ETF, the more likely the price of the ETF will not deviate from the value of its underlying portfolio, making such ETFs less susceptible to price manipulation.

Trading Data for the ETFs Proposed for Cash Settlement

The Exchange believes that average daily notional value is an appropriate proxy for selecting underlying securities that are not readily susceptible to manipulation for purposes of establishing a settlement price. Average daily notional value considers both the trading activity and the price of an underlying security. As a general matter, the more expensive an underlying security’s price, the less cost-effective manipulation could become. Further, manipulation of the price of a security encounters greater difficulty the more volume that is traded. To calculate average daily notional value (provided in the table below), the Exchange summed the notional value of each trade for each symbol (i.e., the number of shares times the price for each execution in the security) and divided that total by the number of trading days in the six-month period (from January 1, 2024 through June 30, 2024) reviewed by the Exchange.

Further, the Exchange proposes that qualifying ETFs also meet an ADV standard. The purpose for this second criteria is to prevent unusually expensive underlying securities from qualifying under the average daily notional value standard while not being one of the most actively traded securities. The Exchange believes an ADV requirement of 4,680,000 shares a day is appropriate because it represents average trading in the underlying ETF of 200 shares per second. While no security is immune from all manipulation, the Exchange believes that the combination of average daily notional value and ADV as prerequisite requirements would limit cash settlement of FLEX ETF Options to those underlying ETFs that would be less susceptible to manipulation in order to establish a settlement price.

The Exchange believes that the proposed objective criteria would ensure that only the most robustly traded and deeply liquid ETFs would qualify to have cash settlement as a contract term. As provided in the below table, from January 1, 2024 to June 30,

2024, the Exchange would be able to provide cash settlement as a contract term for FLEX ETF Options on 46 underlying ETFs, as only this group of securities would currently meet the requirement of \$500 million or more average daily notional value and a

minimum ADV of 4,680,000 shares. The table below provides the list of the 46 ETFs that, for the period covering January 1, 2024 through June 30, 2024, would be eligible to have cash settlement as a contract term.²⁵²

Symbol	Security name	Average daily notional value (in dollars) (1/1/24–6/30/24)	Average daily volume (in shares) (1/1/24–6/30/24)
AGG	iShares Core U.S. Aggregate Bond ETF	\$ 806,096,032	8,295,918
ARKK	ARK Innovation ETF	588,267,283	12,516,087
BIL	SPDR Bloomberg 1–3 Month T-Bill ETF	618,700,170	6,753,925
BND	Vanguard Total Bond Market Index Fund ETF	514,223,054	7,130,093
EEM	iShares MSCI Emerging Markets ETF	1,164,586,979	28,535,696
EFA	iShares MSCI EAFE ETF	1,104,421,854	14,216,699
EMB	iShares JPMorgan USD Emerging Markets Bond ETF	542,748,575	6,149,042
EWJ	iShares MSCI Japan ETF	509,554,399	7,481,823
EWZ	iShares MSCI Brazil ETF	683,919,536	21,690,846
FXI	iShares China Large-Cap ETF	1,027,752,868	42,009,611
GDX	VanEck Gold Miners ETF	774,584,258	24,682,952
GLD	SPDR Gold Shares	1,511,241,142	7,344,884
HYG	iShares iBoxx \$ High Yield Corporate Bond ETF	2,850,542,598	37,011,783
IEF	iShares 7–10 Year Treasury Bond ETF	743,974,086	7,917,457
IEFA	iShares Core MSCI EAFE ETF	577,266,076	7,997,376
IEMG	iShares Core MSCI Emerging Markets ETF	519,063,454	10,129,994
IVV	iShares Core S&P 500 ETF	2,774,452,994	5,417,239
IWM	iShares Russell 2000 ETF	6,731,230,018	33,649,687
IYR	iShares U.S. Real Estate ETF	537,339,035	6,177,644
KRE	SPDR S&P Regional Banking ETF	676,589,675	13,902,921
KWEB	KraneShares CSI China Internet ETF	555,987,739	20,766,407
LQD	Shares iBoxx \$ Investment Grade Corporate Bond ETF	3,007,311,016	27,902,549
NVDL	GraniteShares 2x Long NVDA Daily ETF	682,096,758	11,387,201
QQQ	Invesco QQQ Trust	17,916,413,637	41,065,771
RSP	Invesco S&P 500 Equal Weight ETF	982,482,303	6,062,567
SLV	iShares Silver Trust	602,178,901	24,515,577
SMH	VanEck Semiconductor ETF	1,783,514,710	8,199,564
SOXL	Direxion Daily Semiconductor Bull 3x Shares	2,703,451,838	64,700,251
SOXS	Direxion Daily Semiconductor Bear 3x Shares	695,294,352	92,188,004
SPXL	Direxion Daily S&P 500 Bull 3X Shares	737,685,244	6,096,062
SPY	SPDR S&P 500 ETF Trust	33,559,628,313	66,151,690
SQQQ	ProShares UltraPro Short QQQ ETF	1,461,906,416	131,905,524
TLT	iShares 20+ Year Treasury Bond ETF	3,779,166,025	40,682,936
TNA	Direxion Daily Small Cap Bull 3X Shares	697,479,128	18,832,200
TQQQ	ProShares UltraPro QQQ	3,796,209,774	64,941,840
VCIT	Vanguard Intermediate-Term Corp Bond Idx Fund ETF	597,752,071	7,484,828
VEA	Vanguard Tax Managed Fund FTSE Developed Markets ETF	517,396,977	10,583,858
VOO	Vanguard S&P 500 ETF	2,425,398,743	5,177,005
XBI	SPDR S&P Biotech ETF	979,943,806	10,728,380
XLE	Energy Select Sector SPDR Fund	1,411,567,713	15,798,449
XLF	Financial Select Sector SPDR Fund	1,736,012,363	43,157,138
XLI	Industrial Select Sector SPDR Fund	1,114,661,946	9,277,779
XLK	Technology Select Sector SPDR Fund	1,274,025,061	6,202,031
XLP	Consumer Staples Select Sector SPDR Fund	907,491,273	12,108,426
XLU	Utilities Select Sector SPDR Fund	944,774,031	14,540,920
XLV	Health Care Select Sector SPDR Fund	1,127,277,467	7,876,680

The Exchange believes that permitting cash settlement as a contract term for FLEX ETF Options for the ETFs in the above table would broaden the base of investors that use FLEX Equity Options to manage their trading and investment risk, including investors that currently trade in the OTC market for customized

options, where settlement restrictions do not apply.

²⁵² The Exchange notes that for the period covering January 1, 2024 through June 30, 2024, both the Grayscale Bitcoin Trust (GBTC) and iShares Bitcoin Trust ETF meet the requirements of \$500 million or more average daily notional value and a minimum ADV of 4,680,000 shares. These two ETFs are not listed in the above table because as discussed above, the Exchange is prohibiting FLEX trading on IBIT options. As it relates to GBTC, the Exchange would need to file a 19b–4 rule filing with the Commission to list GBTC options on the

Exchange’s standard non-FLEX market. In the event, however, that the Exchange files to list GBTC options on its standard non-FLEX market, it would still prohibit FLEX trading on GBTC options under this proposal. The Exchange will have system controls in place to ensure that it will only list FLEX Options on ETFs for which it has proper authority, even if those ETFs meet the numerical eligibility criteria.

²⁵³ See, e.g., PHLX FX Options traded on Nasdaq PHLX and S&P 500® Index Options traded on Cboe Options Exchange. The Commission approved, on a pilot basis, the listing and trading of RealDay™ Options on the SPDR S&P 500 Trust on the BOX

The Exchange notes that the SEC has previously approved a rule filing of another exchange that allowed for the trading of cash-settled options²⁵³ and, specifically, cash-settled FLEX ETF Options (which the Exchange proposes to list in the same manner as that exchange).²⁵⁴

Today, equity options are settled physically at The Options Clearing Corporation (“OCC”), *i.e.*, upon exercise, shares of the underlying security must be assumed or delivered. Physical settlement may possess certain risks with respect to volatility and movement of the underlying security at expiration against which market participants may need to hedge. The Exchange believes cash settlement may be preferable to physical delivery in some circumstances as it does not present the same risk. If an issue with the delivery of the underlying security arises, it may become more expensive (and time consuming) to reverse the delivery because the price of the underlying security would almost certainly have changed. Reversing a cash payment, on the other hand, would not involve any such issue because reversing a cash delivery would simply involve the exchange of cash. Additionally, with physical settlement, market participants that have a need to generate cash would have to sell the underlying security while incurring the costs associated with liquidating their position as well as the risk of an adverse movement in the price of the underlying security.

Options Exchange LLC (“BOX”). See Securities Exchange Act Release No. 79936 (February 2, 2017), 82 FR 9886 (February 8, 2017) (“RealDay Pilot Program”). The RealDay Pilot Program was extended until February 2, 2019. See Securities Exchange Act Release No. 82414 (December 28, 2017), 83 FR 577 (January 4, 2018) (SR–BOX–2017–38). The RealDay Pilot Program was never implemented by BOX. See also Securities Exchange Act Release Nos. 56251 (August 14, 2007), 72 FR 46523 (August 20, 2007) (SR–Amex–2004–27) (Order approving listing of cash-settled Fixed Return Options (“FROs”)); and 71957 (April 16, 2014), 79 FR 22563 (April 22, 2014) (SR–NYSEMKT–2014–06) (Order approving name change from FROs to ByRDs and re-launch of these products, with certain modifications).

²⁵⁴ See Securities Exchange Act Release Nos. 88131 (February 5, 2020), 85 FR 7806 (February 11, 2020) (SR–NYSEAMER–2019–38) (Order Approving a Proposed Rule Change, as Modified by Amendment No. 1, to Allow Certain Flexible Equity Options To Be Cash Settled); 97231 (March 31, 2023), 88 FR 20587 (April 6, 2023) (SR–NYSEAMER–2023–22) (Notice of Filing and Immediate Effectiveness of Proposed Change to Make a Clarifying Change to the Term Settlement Style Applicable to Flexible Exchange Options); and 98044 (August 2, 2023), 88 FR 53548 (August 8, 2023) (SR–Cboe–2023–036) (Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Allow Certain Flexible Exchange Equity Options To Be Cash Settled).

With respect to position and exercise limits, cash-settled FLEX ETF Options would be subject to the position limits set forth in proposed Options 3A, Section 18. Accordingly, the Exchange proposes to add subparagraph (b)(1)(B) of Options 3A, Section 18, which would provide that a position in FLEX Equity Options where the underlying security is an ETF that is settled in cash pursuant to Options 3A, Section 3(c)(5)(A)(ii) shall be subject to the position limits set forth in Options 9, Section 13, and subject to the exercise limits set forth in Options 9, Section 15.²⁵⁵ The proposed rule would further state that positions in such cash-settled FLEX Equity Options shall be aggregated with positions in physically settled options on the same underlying ETF for the purpose of calculating the position limits set forth in Options 9, Section 13 and the exercise limits set forth in Options 9, Section 15.²⁵⁶ The Exchange further proposes to add in subparagraph (b)(1)(A) of Section 18 a cross-reference to subparagraph (b)(1)(B) of Section 18, as subparagraph (b)(1)(B) would also contain provisions about position limits for FLEX Equity Options that would be exceptions to the statement in Options 3A, Section 18(b)(1)(A) that FLEX Equity Options have no position limits. The Exchange also proposes to add in paragraph (c) of Section 18, a cross-reference to proposed subparagraph (b)(1)(B), as the proposed rule adds language regarding aggregation of positions for purposes of position limits, which will be covered by paragraph (c). Given that each of the underlying ETFs that would currently be eligible to have cash-settlement as a contract term have established position and exercise limits applicable to physically settled options, the Exchange believes it is appropriate for the same position and exercise limits to also apply to cash-settled options. Accordingly, of the 48 underlying securities that would currently be

²⁵⁵ The Exchange proposes to add to proposed Options 3A, Section 18(b)(1)(A) a cross reference to proposed paragraph (c) of Section 18, as proposed Section 18(c) also contains provisions about position limits for FLEX Equity Options that would be exceptions to the statement in proposed Section 18(b)(1)(A) that FLEX Equity Options have no position limits (in addition to the language in proposed Section 18(b)(1)(B)). The Exchange also proposes to add to proposed Section 18(c) a cross-reference to proposed subparagraph (b)(1)(B) of Section 18, as the proposed rule adds language regarding aggregation of positions for purposes of position limits, which will be covered in proposed Section 18(c).

²⁵⁶ See proposed Options 3A, Section 18(b)(1)(B), which is based on Cboe Rule 8.35(c)(1)(B). The aggregation of position and exercise limits would include all positions on physically settled FLEX and non-FLEX Options on the same underlying ETFs.

eligible to have cash settlement as a FLEX contract term, 33 would have a position limit of 250,000 contracts pursuant to Options 9, Section 13(d)(5).²⁵⁷ Further, pursuant to Supplementary Material .01 to Options 9, Section 13, seven would have a position limit of 500,000 contracts (EWJ, EWZ, TLT, HYG, XLF, LQD, and GDJ); four (EEM, FXI, IWM, and EFA) would have a position limit of 1,000,000 contracts; one (QQQ) would have a position limit of 1,800,000 contracts; and one (SPY) would have a position limit of 3,600,000.²⁵⁸

The Exchange understands that cash-settled ETF options are currently traded in the OTC market by a variety of market participants, *e.g.*, hedge funds, proprietary trading firms, and pension funds.²⁵⁹ These options are not fungible with the exchange listed options. The Exchange believes some of these market participants would prefer to trade comparable instruments on an exchange, where they would be cleared and settled through a regulated clearing agency. The Exchange expects that users of these OTC products would be among the primary users of exchange-traded cash-settled FLEX ETF Options. The Exchange also believes that the trading of cash-settled FLEX ETF Options would allow these same market participants to better manage the risk associated with the volatility of underlying equity positions given the enhanced liquidity that an exchange-traded product would bring.

In the Exchange’s view, cash-settled FLEX ETF Options traded on the Exchange would have three important advantages over the contracts that are traded in the OTC market. First, as a result of greater standardization of contract terms, exchange-traded contracts should develop more liquidity. Second, counter-party credit risk would be mitigated by the fact that the contracts are issued and guaranteed by OCC. Finally, the price discovery and dissemination provided by the

²⁵⁷ Options 9, Section 13(d)(5) provides that to be eligible for the 250,000 contract limit, either the most recent six (6) month trading volume of the underlying security must have totalled at least 100 million shares or the most recent six-month trading volume of the underlying security must have totalled at least seventy-five (75) million shares and the underlying security must have at least 300 million shares currently outstanding. Further as noted above, options on GBTC and IBIT will not be available for FLEX trading.

²⁵⁸ These were based on position limits as of September 13, 2024. Position limits are available on at <https://www.theocc.com>. Position limits for ETFs are always determined in accordance with the Exchange’s Rules regarding position limits.

²⁵⁹ As noted above, other options exchanges have received approval to list certain cash-settled FLEX ETF Options. See *supra* notes 243 and 244.

Exchange and its members would lead to more transparent markets. The Exchange believes that its ability to offer cash-settled FLEX ETF Options would aid it in competing with the OTC market and at the same time expand the universe of products available to interested market participants. The Exchange believes that an exchange-traded alternative may provide a useful risk management and trading vehicle for market participants and their customers. Further, the Exchange believes listing cash-settled FLEX ETF Options would provide investors with competition on an exchange platform, as other options exchanges have received Commission approval to list the same options.²⁶⁰

The Exchange notes that OCC has received approval from the Commission for rule changes that will accommodate the clearance and settlement of cash-settled ETF options and is now clearing these products.²⁶¹ The Exchange has also analyzed its capacity and represents that it and The Options Price Reporting Authority (“OPRA”) have the necessary systems capacity to handle the additional traffic associated with the listing of cash-settled FLEX ETF Options. The Exchange believes any additional traffic that would be generated from the introduction of cash-settled FLEX ETF Options would be manageable. The Exchange expects that members will not have a capacity issue as a result of this proposed rule change. The Exchange also does not believe this proposed rule change will cause fragmentation of liquidity. The Exchange will monitor the trading volume associated with the additional options series listed as a result of this proposed rule change and the effect (if any) of these additional series on market fragmentation and on the capacity of the Exchange’s automated systems.

The Exchange does not believe that allowing cash settlement as a contract term would render the marketplace for equity options more susceptible to manipulative practices. The Exchange believes that manipulating the settlement price of cash-settled FLEX ETF Options would be difficult based on the size of the market for the underlying ETFs that are the subject of this proposed rule change. The Exchange notes that each underlying ETF in the table above is sufficiently active to alleviate concerns about potential manipulative activity. Further, in the Exchange’s view, the vast liquidity in the 46 underlying ETFs that

would currently be eligible to be traded as cash-settled FLEX options under the proposal ensures a multitude of market participants at any given time. Moreover, given the high level of participation among market participants that enter quotes and/or orders in physically settled options on these ETFs, the Exchange believes it would be very difficult for a single participant to alter the price of the underlying ETF or options overlying such ETF in any significant way without exposing the would-be manipulator to regulatory scrutiny. The Exchange further believes any attempt to manipulate the price of the underlying ETF or options overlying such ETF would also be cost prohibitive. As a result, the Exchange believes there is significant participation among market participants to prevent manipulation of cash-settled FLEX ETF Options.

Still, the Exchange believes it has an adequate surveillance program in place and intends to apply the same program procedures to cash-settled FLEX ETF Options that it applies to the Exchange’s other options products.²⁶² The Exchange will periodically review its surveillance procedures and make any changes that the Exchange believes are necessary for FLEX trading. FLEX options products and their respective symbols will be integrated into the Exchange’s existing surveillance system architecture and will thus be subject to the relevant surveillance processes, as applicable. The Exchange believes that the existing surveillance procedures at the Exchange are capable of properly identifying unusual and/or illegal trading activity, which procedures the Exchange would utilize to surveil for aberrant trading in cash-settled FLEX ETF Options.

With respect to regulatory scrutiny, the Exchange believes its existing surveillance technologies and procedures adequately address potential concerns regarding possible manipulation of the settlement value at or near the close of the market. The Exchange notes that the regulatory program operated by and overseen by ISE²⁶³ includes cross-market surveillance designed to identify manipulative and other improper trading, including spoofing, algorithm

gaming, marking the close and open, as well as more general, abusive behavior related to front running, wash sales, and quoting/routing, which may occur on the Exchange or other markets.²⁶⁴ These cross-market patterns incorporate relevant data from various markets beyond the Exchange and its affiliates and from markets not affiliated with the Exchange. The Exchange represents that, today, its existing trading surveillances are adequate to monitor trading in the underlying ETFs and subsequent trading of options on those securities listed on the Exchange. Further, with the introduction of cash-settled FLEX ETF Options, the Exchange would leverage its existing surveillances to monitor trading in the underlying ETFs and subsequent trading of options on those securities listed on the Exchange with respect to cash-settled FLEX ETF options.²⁶⁵

Additionally, for options, the Exchange utilizes an array of patterns that monitor manipulation of options, or manipulation of equity securities (regardless of venue) for the purpose of impacting options prices on the Exchange (*i.e.*, mini-manipulation strategies). That surveillance coverage is initiated once options begin trading on the Exchange. Accordingly, the Exchange believes that the cross-market surveillance performed by the Exchange or FINRA, on behalf of the Exchange, coupled with ISE’s own monitoring for violative activity on the Exchange comprise a comprehensive surveillance program that is adequate to monitor for manipulation of the underlying ETF and overlying option. Furthermore, the Exchange believes that the existing surveillance procedures at the Exchange are capable of properly identifying unusual and/or illegal trading activity, which the Exchange would utilize to surveil for aberrant trading in cash-settled FLEX ETF Options.

In addition to the surveillance procedures and processes described above, improvements in audit trails (*i.e.*,

²⁶⁴ As it relates to Reg SHO violations, the Exchange will enforce this through its Stock-Tied Reg SHO price protections in Options 3, Section 16(e). *See supra* note 205 for Stock-Tied Reg SHO discussion. NES will only execute Stock-Option Strategies and Stock-Complex Strategies if the underlying covered security component is in accordance with Rule 201 of Regulation SHO. Additionally, FINRA’s regulatory program addresses Reg SHO compliance for its member firms (which includes Exchange Members).

²⁶⁵ Such surveillance procedures generally focus on detecting securities trading subject to opening price manipulation, closing price manipulation, layering, spoofing or other unlawful activity impacting an underlying security, the option, or both. The Exchange has price movement alerts, unusual market activity and order book alerts active for all trading symbols.

²⁶⁰ *See supra* notes 243 and 244.

²⁶¹ *See* Securities Exchange Act Release No. 34–94910 (May 13, 2022), 87 FR 30531 (May 19, 2022) (SR–OCC–2022–003).

²⁶² For example, the regulatory program for the Exchange includes surveillance designed to identify manipulative and other improper options trading, including, spoofing, marking the close, front running, wash sales, etc.

²⁶³ ISE maintains a regulatory services agreements with Financial Industry Regulatory Authority, Inc. (“FINRA”) whereby FINRA provides certain regulatory services to the exchanges, including cross-market surveillance, investigation, and enforcement services.

the Consolidated Audit Trail), recordkeeping practices, and inter-exchange cooperation over the last two decades have greatly increased the Exchange's ability to detect and punish attempted manipulative activities. In addition, the Exchange is a member of the ISG. The ISG members work together to coordinate surveillance and investigative information sharing in the stock and options markets. For surveillance purposes, the Exchange would therefore have access to information regarding trading activity in the pertinent underlying securities.

The proposed rule change is designed to allow investors seeking to effect cash-settled FLEX ETF Options with the opportunity for a different method of settling option contracts at expiration if they choose to do so. As noted above, market participants may choose cash settlement because physical settlement possesses certain risks with respect to volatility and movement of the underlying security at expiration that market participants may need to hedge against. The Exchange believes that offering innovative products flows to the benefit of the investing public. A robust and competitive market requires that exchanges respond to members' evolving needs by constantly improving their offerings. Such efforts would be stymied if exchanges were prohibited from offering innovative products for reasons that are generally debated in academic literature. The Exchange believes that introducing cash-settled FLEX ETF Options would further broaden the base of investors that use FLEX Equity Options to manage their trading and investment risk, including investors that currently trade in the OTC market for customized options, where settlement restrictions do not apply. The proposed rule change is also designed to encourage market makers to shift liquidity from the OTC market onto the Exchange, which, it believes, would enhance the process of price discovery conducted on the Exchange through increased order flow. The Exchange also believes that this may open up cash-settled FLEX ETF Options to more retail investors. The Exchange does not believe that this proposed rule change raises any unique regulatory concerns because existing safeguards—such as position limits (and the aggregation of cash-settled positions with physically-settled positions), exercise limits (and the aggregation of cash-settled positions with physically-settled positions), and reporting requirements—would continue to apply. The Exchange believes the proposed position and exercise limits may further help mitigate

the concerns that the limits are designed to address about the potential for manipulation and market disruption in the options and the underlying securities.²⁶⁶

Given the novel characteristics of cash-settled FLEX ETF Options, the Exchange will conduct a review of the trading in cash-settled FLEX ETF Options over an initial five-year period. The Exchange will furnish five reports to the Commission based on this review, the first of which would be provided within 60 days after the first anniversary of the initial listing date of the first cash-settled FLEX ETF Option under the proposed rule and each subsequent annual report to be provided within 60 days after the second, third, fourth and fifth anniversary of such initial listing. At a minimum, each report will provide a comparison between the trading volume of all cash-settled FLEX ETF Options listed under the proposed rule and physically settled options on the same underlying security, the liquidity of the market for such options products and the underlying ETF, and any manipulation concerns arising in connection with the trading of cash-settled FLEX ETF Options under the proposed rule. The Exchange will also provide additional data as requested by the Commission during this five year period. The reports will also discuss any recommendations the Exchange may have for enhancements to the listing standards based on its review. The Exchange believes these reports will allow the Commission and the Exchange to evaluate, among other things, the impact such options have, and any potential adverse effects, on price volatility and the market for the underlying ETFs, the component securities underlying the ETFs, and the options on the same underlying ETFs and make appropriate recommendations, if any, in response to the reports.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,²⁶⁷ in general, and furthers the objectives of Section 6(b)(5) of the Act.²⁶⁸ Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)²⁶⁹ requirements that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation

and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Exchange believes that the adoption of the proposed rules allowing FLEX Options to trade on ISE in the manner specified above is consistent with the goals of the Act to remove impediments to and perfect the mechanism of a free and open market because it will benefit market participants by providing an additional venue for market participants to provide and seek liquidity for FLEX Options. As the Commission noted in its order granting FLEX trading on Cboe and what was then the Pacific Stock Exchange (now NYSE Arca), trading FLEX Options on an exchange is an alternative to trading customized options in OTC markets and carries with it the advantages of exchange markets such as transparency, parameters and procedures for clearance and settlement, and a centralized counterparty clearing agency.²⁷⁰ Therefore, the Exchange believes the proposed rule change will promote these same benefits for the market as a whole by providing an additional venue for market participants to trade customized FLEX Options. The Exchange believes that providing an additional venue for FLEX Options will be beneficial by increasing competition for order flow and executions.

In general, transactions in FLEX Options will be subject to many of the same rules that currently apply to non-FLEX Options traded on the Exchange. In order to provide investor with the flexibility to designate terms of the options and accommodate the special trading of FLEX Options, however, the Exchange is proposing to add new rules in proposed Options 3A that will apply solely to FLEX Options. As noted above, the proposed rules are largely consistent with Cboe's rules pertaining to electronic FLEX Options, with certain intended differences primarily to align to current System behavior (and especially current auction behavior) to provide increased consistency for Members trading FLEX Options and non-FLEX Options on ISE, each as discussed above and below. Further, the Exchange has omitted certain Cboe rules from the proposed rules due to

²⁶⁶ See *supra* note 256.

²⁶⁷ 15 U.S.C. 78f(b).

²⁶⁸ 15 U.S.C. 78f(b)(5).

²⁶⁹ 15 U.S.C. 78f(b)(5).

²⁷⁰ See Securities Exchange Act Release No. 36841 (February 14, 1996), 61 FR 6666 (February 21, 1996) (SR-CBOE-95-43) (SR-PSE-95-24) (Order Approving the Trading of Flexibly Structured Equity Options by CBOE and PSE).

differences in scope and operation of FLEX trading at Cboe compared to the proposed scope and operation of FLEX trading on ISE, each as noted above. For example, the Exchange will not include Cboe rule provisions related to floor trading, Asian- or Cliquet-settled FLEX Index Options, or Micro FLEX Index Options as it does not offer these capabilities today. For the same reason, the Exchange will not allow prices in FLEX trading to be expressed as percentages under this proposal.

The Exchange further believes that its proposal is designed to prevent fraudulent and manipulative acts and practices as the Exchange believes that it has an adequate surveillance program in place and intends to apply the same program procedures to FLEX Options that is applied to the Exchange's other options products, as applicable. As described above, FLEX Option products and their respective symbols will be integrated into the Exchange's existing surveillance system architecture and will be subject to the relevant surveillance processes, thereby allowing the Exchange to properly identify disruptive and/or manipulative trading activity.

A. General Provisions (Section 1)

The Exchange believes that proposed Section 1(a) setting forth the applicability of Exchange Rules will make clear that unless otherwise provided in proposed Options 3A, the Exchange's existing rules will continue to apply to FLEX Options, which will provide consistency for Members trading both FLEX Options and non-FLEX Options on ISE.

The Exchange believes that the defined terms proposed in Section 1(b) will provide increased clarity to Members by specifying definitions like "FLEX Option" and "FLEX Order" that are used throughout Options 3A. The Exchange further believes that adding the definition of "FLEX Order" in Options 3, Section 7(z) will add transparency as to which order types would be available on ISE. Lastly, the non-substantive change proposed in Options 3, Section 7(y) will bring clarity and avoid potential confusion for market participants.

B. Hours of Business (Section 2)

The Exchange believes that specifying the trading hours for FLEX Options in proposed Section 2(a) will provide increased clarity that the trading hours for FLEX Options will generally be the same as the trading hours for corresponding non-FLEX Options as set forth in Options 3, Section 1. As noted above, the proposed language is

materially identical to Cboe Rule 5.1(b)(3)(A).

As it relates to the Exchange's proposed discretion relating to the trading hours for FLEX Options, this is consistent with Cboe's FLEX Options rules as noted above. The Exchange believes that because of the unique nature of FLEX, in contrast to the non-FLEX market, it is reasonable to permit the Exchange, in its discretion, to narrow or otherwise restrict the trading hours for FLEX Options, so long as such trading hours occur within the normal options trading hours of the Exchange described above. The Exchange would provide adequate advance notification to its Members of such changes in FLEX trading hours.

C. FLEX Option Classes and Permissible Series (Section 3(a) and (b))

The Exchange believes that the proposed rule text in Sections 3(a) and 3(b) will provide greater transparency around the Exchange's listing standards for FLEX Option classes and FLEX Option series. As described above, the Exchange is proposing to exclude IBIT options from being eligible for trading as a FLEX Option on ISE. The Exchange believes this is consistent with the Act because it aligns to ISE's approval order of IBIT options, which required the position limit for IBIT options to be 25,000 contracts. As discussed in the position limits section above, there will generally be no position limits for FLEX Equity Options. The Exchange therefore proposes to exclude IBIT options from being eligible to trade as a FLEX Option to continue to limit the position limits for IBIT options.

Proposed Section 3(b)(1), which will prevent FLEX Options and non-FLEX Options with the same terms from trading concurrently by System enforcing this restriction, is consistent with the Act because this restriction will address concerns that FLEX Options would act as a surrogate for the trading of non-FLEX Options. In particular, a non-FLEX Option trading pursuant to Options 3 has different priority rules than a FLEX Option trading pursuant to proposed Options 3A.²⁷¹ Allowing an option with the

²⁷¹ For example, the Exchange's order books will be inapplicable to FLEX Orders and thus certain priority provisions in Options 3, Section 10 applicable to non-FLEX Orders will not be applicable to FLEX Orders, such as the enhanced Primary Market Maker priority in Section 10(c)(1)(B), Preferred Market Maker priority in Section 10(c)(1)(C), and entitlement for orders of 5 contracts or fewer in Section 10(c)(1)(D). FLEX Options will instead be subject to the priority provisions in Options 3A, Section 11(b)(3)(A) (electronic FLEX Auctions), Section 12(e) (FLEX PIM), and Section 13(e) (FLEX SOM).

same terms to trade under both rules concurrently would result in inconsistent order handling and could allow the order priority of non-FLEX Orders to be circumvented. Therefore, the Exchange proposes to prevent this situation by permitting FLEX Options transactions only in options with a different term (exercise style, expiration date, or exercise price) than a non-FLEX Option on the same underlying security or index that is already listed for trading. As noted above, the proposed language in Section 3(a) and Section 3(b) is substantially similar to Cboe Rule 4.20, Rule 4.21(a), and Rule 4.22(c) respectively, except the Exchange is clarifying in proposed Section 3(b)(2) that on the expiration date, a FLEX Order for the expiring FLEX Option series may only be submitted to close out a position in such expiring FLEX Option series.²⁷²

D. FLEX Options Terms (Section 3(c))

The Exchange believes that the terms of FLEX Options pursuant to proposed Options 3A, Section 3(c) serve to perfect the mechanism of a free and open market and a national market system because they will permit investors to customize some of the terms of their FLEX Options to implement more precise trading strategies, which may not be possible using non-FLEX Options. These investors may have improved capability to execute strategies to meet their specific investment objectives by using customized FLEX Options. However, only certain terms as specified in proposed Section 3(c) are subject to flexible structuring by the parties to the FLEX Option transactions, and most of such terms have a specified number of alternative configurations. The Exchange believes that these restrictions are reasonable and designed to further the objectives of the Act and to promote just and equitable principles of trade because limiting FLEX Option terms enables the efficient, centralized clearance and settlement and active secondary trading of opened FLEX Options. As noted above, these terms are consistent with Cboe Rule 4.21(b) except the Exchange will not incorporate applicable Cboe provisions relating to Asian- or Cliquet-settled FLEX Options, Micro FLEX Index Options, or relating to prices that are expressed as a percentage value because the Exchange does not offer these features today.

²⁷² The Exchange will System enforce this provision such that it will reject an opening position in an expiring FLEX Option series on the day of expiration.

As discussed above, the Exchange is proposing to allow the listing of FLEX PM Third Friday Options on ISE, consistent with the Commission's recent approval of Cboe's proposal to make its pilot a permanent program.²⁷³ The Exchange believes that aligning to Cboe will allow ISE to compete effectively with Cboe's product offering. Like Cboe, the Exchange believes that FLEX PM Third Friday Options will provide investors with greater trading opportunities and flexibility. The Exchange notes that the Commission recently approved proposals to make other pilots permitting p.m.-settlement of index options permanent after finding those pilots were consistent with the Act and the options subject to those pilots had no significant impact on the market.²⁷⁴

The Exchange further believes that permitting ISE to list FLEX PM Third Friday Options, similar to Cboe, will remove impediments to and perfect the mechanism of a free and open market and a national market system and protect investors, while maintaining a fair and orderly market. As described in the FLEX Settlement Pilot Approval, Cboe observed no significant adverse market impact or identified any meaningful regulatory concerns during the nearly 14-year operation of the FLEX PM Third Friday Program as a pilot nor during the 15 years since P.M.-settled index options (SPX) were reintroduced to the marketplace.²⁷⁵

²⁷³ See *supra* note 52.

²⁷⁴ See Securities Exchange Act Release Nos. 98454 (September 20, 2023) (SR-CBOE-2023-005) (order approving proposed rule change to make permanent the operation of a program that allows the Exchange to list p.m.-settled third Friday-of-the-month SPX options series) ("SPXPM Approval"); 98455 (September 20, 2023) (SR-CBOE-2023-019) (order approving proposed rule change to make permanent the operation of a program that allows the Exchange to list p.m.-settled third Friday-of-the-month XSP and MRUT options series) ("XSP and MRUT Approval"); and 98456 (September 20, 2023) (SR-CBOE-2023-020) (order approving proposed rule change to make the nonstandard expirations pilot program permanent) ("Nonstandard Approval"). See also Securities Exchange Act Release Nos. 98450 (September 20, 2023), 88 FR 66111 (September 26, 2023) (SR-ISE-2023-08) (order approving proposed rule change to make permanent certain p.m.-settled pilots); and 98935 (November 14, 2023), 88 FR 80792 (November 20, 2023) (SR-ISE-2023-20) (order approving a proposed rule change to permit the listing and trading of p.m.-settled Nasdaq-100 Index® Options with a third-Friday-of-the-month expiration).

²⁷⁵ Notably, Cboe did not identify any significant economic impact (including on pricing or volatility or in connection with reversals) on related futures, the underlying indexes, or the underlying component securities of the underlying indexes surrounding the close as a result of the quantity of FLEX PM Third Friday Options or the amount of expiring open interest in FLEX PM Third Friday Options, nor any demonstrated capacity for options hedging activity to impact volatility in the underlying markets. See *supra* note 52.

As discussed in the FLEX Settlement Pilot Approval, the DERA staff study²⁷⁶ and corresponding Cboe study concluded that a significantly larger amount of non-FLEX p.m.-settled index options had no significant adverse market impact and caused no meaningful regulatory concerns. Therefore, Cboe concluded that the relatively small amount of FLEX Index Option volume would similarly have no significant adverse market impact or cause no meaningful regulatory concerns.²⁷⁷

Cboe also concluded that the introduction of FLEX PM options had no significant impact on the market quality of corresponding a.m.-settled options or other options. As discussed in the FLEX Settlement Pilot Approval, Cboe's analysis conducted after the introduction of SPXW options with Tuesday and Thursday expirations demonstrated no statistically significant impact on the bid-ask or effective spreads of SPXW options with Monday, Wednesday, and Friday expirations after trading in the SPXW options with Tuesday and Thursday expirations began.²⁷⁸ Further, Cboe concluded that large FLEX PM Third Friday Options trades had no material negative impact (and likely no impact) on quote quality of non-FLEX a.m.-settled options overlying the same index with similar terms as the FLEX PM Third Friday Option upon evaluating data that showed that the spreads were relatively stable before and after large trades.²⁷⁹

²⁷⁶ See FLEX Settlement Pilot Approval, citing to Securities and Exchange Commission, Division of Economic Risk and Analysis, Memorandum dated February 2, 2021 on Cornerstone Analysis of PM Cash-Settled Index Option Pilots (September 16, 2020), available at: https://www.sec.gov/files/Analysis_of_PM_Cash_Settled_Index_Option_Pilots.pdf.

²⁷⁷ See *supra* note 52. Additionally, these studies measured any impact on related futures, the underlying indexes, or the underlying component securities of the underlying indexes surrounding the close. Despite FLEX SPX options (which represent approximately half of the year-to-date 2023 volume of FLEX Index Options but only approximately 0.3% of total SPX volume) not being included in the DERA staff study and corresponding Cboe study, those studies concluded that during the time periods covered (which included the period of time in which the Pilot Program has been operating), there was no significant economic impact on the underlying index or related products. Therefore, Cboe concluded that any FLEX SPX Options that executed during the timeframes covered by the studies had no significant impact on the underlying index or related products, as neither DERA staff nor Cboe observed any significant economic impact on the underlying index or related product.

²⁷⁸ See *supra* note 52.

²⁷⁹ Specifically, Cboe evaluated each FLEX PM Third Friday Options trade for more than 500 contracts that occurred on Cboe during a two-year timeframe and analyzed the market quality (specifically, the average time-weighted quote

Therefore, Cboe concluded that it is likely that FLEX PM Third Friday Options have had no significant negative impact on the market quality of non-FLEX Options with a.m.-settlement.²⁸⁰

Additionally, Cboe noted that the significant changes in the closing procedures of the primary markets in recent decades, including considerable advances in trading systems and technology, has significantly minimized risks of any potential impact of FLEX PM Third Friday Options on the underlying cash markets. As such, Cboe concluded that listing FLEX PM Third Friday Options did not raise any unique or prohibitive regulatory concerns and that such trading has not, and will not, adversely impact fair and orderly markets on expiration Fridays for the underlying indexes or their component securities.

The Exchange notes that p.m.-settled options were previously approved on ISE's standard market,²⁸¹ including p.m.-settled third-Friday-of-the-month expirations for NDX options.²⁸² In the P.M.-Settled Pilot Permanency Approval, the Commission stated it believed that the evidence contained in the Exchange's filing, the Exchange's pilot data and reports, and the DERA staff study²⁸³ analysis demonstrate that the Exchange's pilot programs have benefitted investors and other market participants by providing more flexible trading and hedging opportunities while

spread and size 30 minutes prior to the trade and the average time-weighted quote spread and size 30 minutes after the trade) of series non-FLEX a.m.-settled options overlying the same index with similar terms as the FLEX PM Third Friday Option that traded (time to expiration, type (call or put), and strike price) as set forth in the Cboe's data. See *supra* note 52.

²⁸⁰ Cboe acknowledged that, while FLEX PM Third Friday Options has historically represented a very small percentage of overall volume, it is possible trading in these options may grow in the future. See *supra* note 52.

²⁸¹ See Securities Exchange Act Release No. 98450 (September 20, 2023), 88 FR 66111 (September 26, 2023) (SR-ISE-2023-08) (Order Granting Approval of a Proposed Rule Change, as Modified by Amendment No. 1, To Make Permanent Certain P.M.-Settled Pilots) ("P.M.-Settled Pilot Permanency Approval").

²⁸² See Securities Exchange Act Release No. 98935 (November 14, 2023), 88 FR 80792 (November 20, 2023) (SR-ISE-2023-20) (Order Approving a Proposed Rule Change To Permit the Listing and Trading of P.M.-Settled Nasdaq-100 Index® Options With a Third-Friday-of-the-Month Expiration) ("P.M. Third Friday NDX Options Approval").

²⁸³ See P.M.-Settled Pilot Permanency Approval, citing to Securities and Exchange Commission, Division of Economic Risk and Analysis, Memorandum dated February 2, 2021 on Cornerstone Analysis of PM Cash-Settled Index Option Pilots (September 16, 2020) (also referred to therein as the "Pilot Memo"), available at: https://www.sec.gov/files/Analysis_of_PM_Cash_Settled_Index_Option_Pilots.pdf.

also having no disruptive impact on the market.²⁸⁴ The Commission also stated that the market for p.m.-settled options has grown in size over the course of the Exchange's pilot programs, and analysis of the pilot data did not identify any significant economic impact on the underlying component securities surrounding the close as a result of expiring p.m.-settled options nor did it indicate a deterioration in market quality (as measured by relative quoted spreads) for an existing product when a new p.m.-settled expiration was introduced.²⁸⁵ Further, the Commission stated that significant changes in closing procedures in the decades since index options moved to a.m. settlement may also serve to mitigate the potential impact of p.m.-settled index options on the underlying cash markets.²⁸⁶

In support of its proposal to list p.m.-settled third-Friday-of-the-month expirations for NDX options on its standard market, the Exchange pointed to, among other things, the data it provided underlying the P.M.-Settled Pilot Permanency Approval.²⁸⁷ In reviewing this data from the Exchange (and other options exchanges in support of similar proposals to list and trade certain p.m.-settled broad-based index options) as well as the DERA staff study analysis, the Commission concluded that analysis of the pilot data did not identify any significant economic impact on the underlying component securities surrounding the close as a result of expiring p.m.-settled options nor did it indicate a deterioration in market quality for an existing product when a new p.m.-settled expiration was introduced.²⁸⁸ Further, the Commission made similar findings as those in the P.M.-Settled Pilot Permanency Approval that significant changes in closing procedures in the decades since index options moved to a.m. settlement may also serve to mitigate the potential impact of p.m.-settled index options on the underlying cash markets.²⁸⁹ The Exchange has observed no significant adverse market impact or identified any meaningful regulatory concerns since the introduction of p.m.-settled index options on its standard market.²⁹⁰ Given

that the Exchange anticipates FLEX PM Third Friday Options to have a relatively smaller amount of volume compared to its standard non-FLEX p.m.-settled index options market, the Exchange believes that introducing FLEX PM Third Friday coupled with the other findings in Cboe's FLEX Settlement Pilot Approval would likely have no significant adverse market impact or cause any meaningful regulatory concerns as well.

E. FLEX Fungibility (Section 3(d))

The Exchange believes that the FLEX fungibility provisions in proposed Options 3A, Section 3(d) are consistent with the Act by preventing new FLEX Option positions from being opened when a non-FLEX Option with the same terms is listed for trading. Pursuant to proposed Section 3(d)(1), a FLEX Option with the same terms as a subsequently added non-FLEX Option would become fungible with the non-FLEX Option. Accordingly, once a non-FLEX Option is added with the same terms as an outstanding FLEX Option, the FLEX Option would effectively become a standardized, non-FLEX Option and trade under the same rules and procedures that apply to any other standard non-FLEX Option. The Exchange believes that enforcing consistent order handling for identical and fungible options prevents fraudulent and manipulative acts and practices, and promotes just and equitable principles of trade to protect investors and the public interest by ensuring consistent treatment of these options. As noted above, proposed Section 3(d)(1) is materially identical to Cboe Rule 4.22(a).

Additionally, pursuant to proposed Section 3(d)(2)(A), if a non-FLEX Option series²⁹¹ is added intraday, for the balance of that trading day, a position established under the FLEX trading procedures may be closed using the FLEX trading procedures in this Options 3A against another closing only FLEX position. No FLEX Orders may be

of-the-month expirations on NDX options on or before the launch of electronic FLEX on ISE.

²⁹¹ As noted above, Cboe Rule 4.22(b)(1) currently indicates that Cboe's closing-only provisions apply if a non-FLEX Option *American-style* series is added intraday. The Exchange, however, believes it is more straightforward to apply the closing-only provisions to *all* non-FLEX Option series (*i.e.*, American-style and European-style FLEX Option series) instead of limiting these provisions to one type of exercise style. As such, the Exchange's proposed language in Options 3A, Section 3(d)(2)(A) will instead provide that the Exchange's closing-only provisions would apply "if a non-FLEX Option series is added intraday." See BOX Rule 7605(d)(3), which similarly does not limit BOX's closing-only provisions to American-style FLEX Options series.

submitted into an electronic auction pursuant to Options 3A, Sections 11(b), 12, or 13 for a FLEX Option series with the same terms as the non-FLEX Option series, unless the FLEX Order is a closing order, and it is the day on which the non-FLEX Option series was added intraday; Members may only submit responses that close out existing FLEX positions. The Exchange notifies Members when a FLEX Option series is restricted to closing only transactions. The System will reject a transaction in such a restricted series that does not conform to these requirements.

This proposed rule will prevent an option with the same terms from trading both a FLEX Option series and a non-FLEX Option series concurrently, while providing a narrow exception for closing positions. The Exchange believes that providing a narrow exception to permit such closing only transactions will help investors close out their outstanding FLEX Option positions the same day as the identical non-FLEX Option is added. As noted above, proposed Section 3(d)(2) is substantially similar to other options exchanges.²⁹²

F. Units of Trading; Minimum Trading Increments (Sections 4 and 5)

The Exchange believes that the proposed rule text in Section 4(a) provides clear, transparent language regarding how bids and offers for FLEX Options must be expressed. As noted above, proposed Section 4(a) is consistent with Cboe Rule 5.3(e)(3) except the Exchange is not proposing to provide for Micro FLEX Index Options or to allow prices to be expressed as a percentage value because the Exchange does not offer these features today and does not intend to introduce such features under this proposal.

The Exchange similarly believes that proposed Section 5(a) provides clarity to market participants that the Exchange will determine the minimum increments for bids and offers on FLEX Options on a class-by-class basis, which may be no smaller than \$0.01 for the options leg of a FLEX Option. Allowing FLEX Options to trade in increments as small as \$0.01 is consistent with the Act because it provides investors with increased ability to meet their specific investment objectives and allows for increased opportunities for price improvement through a finer trading increment. As noted above, proposed Section 5(a) is consistent with Cboe

²⁹² In particular, proposed Options 3A, Sections 3(d)(2)(A) and (B) are based on Cboe Rule 4.22(b) and BOX Rule 5055(f)(3), respectively. See *supra* notes 57 and 58.

²⁸⁴ See P.M.-Settled Pilot Permanency Approval.

²⁸⁵ See *id.*

²⁸⁶ See *id.*

²⁸⁷ See P.M.-Settled Pilot Permanency Approval and P.M. Third Friday NDX Options Approval in notes 272 and 273, respectively.

²⁸⁸ See P.M. Third Friday NDX Options Approval.

²⁸⁹ See *id.*

²⁹⁰ While the Exchange has received approval to list p.m.-settled third Friday-of-the-month expirations for NDX options on its standard market pursuant to the Third Friday NDX Options Approval, the Exchange has not listed them to date. The Exchange will launch p.m.-settled third-Friday-

Rule 5.4(c)(4) except the Exchange is not proposing to allow prices to be expressed as a percentage value and the Exchange is also clarifying that proposed Section 5(a) would apply to the options leg of a FLEX Option. The Exchange is also proposing to clarify in proposed Section 5(b) that the stock leg of a FLEX Option will be subject to the minimum increment rules in proposed Options 3A, Section 11(b)(1)(G), Section 12(a)(5), and Section 13(a)(5) for greater transparency around how minimum increments for complex FLEX Orders (including complex FLEX Orders with a stock component) would be handled.

G. Types of Orders; Order and Quote Protocols (Section 6)

The Exchange believes that specifying in proposed Section 6(a) that it may make the order types and TIFs specified in Options 3, Section 7 available on a class or System basis for FLEX Orders is consistent with the Exchange's existing authority to designate the availability of order types and times-in-force for non-FLEX Orders.²⁹³ As noted above, only the following order types in Options 3, Section 7 would apply to FLEX at this time: Limit Orders and Cancel and Replace Orders. Also as noted above, only the Immediate-or-Cancel TIF described in Supplementary Material .02(d) would apply to FLEX. Given that FLEX Orders will only be eligible to be submitted into an electronic FLEX Auction, FLEX PIM, or FLEX SOM, and not rest on the order book or route away (for which most of the order types and TIFs set forth in Options 3, Section 7 are relevant), the Exchange believes that these are appropriate designations for FLEX Orders. Because there is no existing market for FLEX Options on the Exchange, the Exchange believes that permitting FLEX Options to be submitted as limit orders is appropriate to ensure execution of FLEX Orders at reasonable prices (*i.e.*, at the Member's specified price or better). The Exchange also believes that it is appropriate to allow FLEX Orders to be submitted as Cancel and Replace orders so that Members can cancel and replace their FLEX Order in a single message. The Exchange further believes that it is appropriate to allow FLEX Orders to have a TIF of Immediate-or-Cancel because that is how the Exchange currently treats all auction orders in its standard non-FLEX market today. Specifically, the Exchange considers all orders that are entered into one of its non-FLEX auction mechanisms (*e.g.*, SOM Orders and PIM Orders) to have a

TIF of Immediate-or-Cancel. By their terms, these orders will be: (1) executed either on entry or after an exposure period, or (2) cancelled.²⁹⁴ Because FLEX Orders may only be submitted into one of the proposed auctions described above (FLEX Auction, FLEX PIM, FLEX SOM), the Exchange will likewise consider FLEX Orders like its non-FLEX auction orders today.

The Exchange further believes proposed Section 6(b) will provide greater transparency as to which existing order and quote protocols would be available for FLEX Orders, FLEX auction notifications, and FLEX auction responses.

H. Complex Orders (Section 7)

The Exchange believes the proposed Section 7 will provide investors with additional transparency regarding order entry requirements for complex FLEX Options. As noted above, the proposed complex FLEX Order entry requirements will be consistent with Cboe Rule 5.70(b), except the Exchange will not offer Asian-settled or Cliquet-settled FLEX Index Options.

The Exchange also believes that allowing the submission of complex FLEX Orders with any ratio will remove impediments to and perfect the mechanism of a free and open market and benefit investors, because it will provide Members with additional flexibility and precision in their investment strategies. As noted above, Cboe already offers this feature for complex FLEX Orders, so the Exchange believes that the proposed changes will promote a free and open market and a national market system by providing an additional venue for market participants to execute complex FLEX Orders with any ratio.²⁹⁵

I. Opening of FLEX Trading (Section 8)

The Exchange believes that proposed Section 8, which will specify that there will be no Opening Process in FLEX Options and that Members may begin submitting FLEX Orders into an electronic FLEX Auction, a FLEX PIM, or a FLEX SOM when the underlying security is open for trading, will provide clarity to market participants regarding the mechanisms available for FLEX trading. The Exchange will not conduct an Opening Process in FLEX Options due to the customized nature of these products and the fact that there will be no requirement for specific FLEX Option series to be quoted or traded each day. The Exchange notes that Cboe

likewise does not hold an opening trading rotation in FLEX Options.²⁹⁶

The Exchange also believes that allowing Member to begin submitting FLEX Orders once the underlying security is open is appropriate. Because market participants incorporate transaction prices of underlying securities or the values of underlying indexes when pricing options (which will include FLEX Options), the Exchange believes it will benefit investors for FLEX Options trading to not be available until that information has begun to be disseminated in the market. Because the Exchange will have no electronic book of resting orders for FLEX Options (and no Opening Process), being "open" for FLEX trading merely means that Members may submit FLEX Orders into one of the specified FLEX auction mechanisms once the underlying is open, at the conclusion of which executions in those auction mechanisms may occur (which are all discussed in the respective FLEX Auction, FLEX PIM, and FLEX SOM sections above).

J. Trading Halts (Section 9)

The Exchange believes that proposed Section 9 will provide clarity as to when the Exchange would halt trading in FLEX Options. The reasons why the Exchange would halt trading in a non-FLEX Option class (*e.g.*, trading in the underlying security is halted) would generally be reasons why the Exchange would halt a FLEX Option class, and therefore the Exchange will always halt trading in a FLEX Option class when trading in a non-FLEX Option class with the same underlying equity security or index is halted on the Exchange. Proposed Section 9 also provides the Exchange with authority to halt trading in a FLEX Option, even if trading in a non-FLEX Option with the same underlying is not halted. While such situation would be rare, there may be unusual circumstances that would cause the Exchange to halt trading in the FLEX Option. As noted above, the proposed halt provisions are consistent with Cboe Rule 4.21(a)(3).

K. Exchange Order Books (Section 10)

The Exchange believes that specifying in proposed Section 10 that the Exchange's simple and complex order books will not be available for transactions in FLEX Options will make clear what mechanisms would be available for FLEX trading (or not). FLEX Orders may only be submitted into a FLEX Auction, FLEX PIM, or FLEX SOM. As noted above, proposed

²⁹³ See introductory paragraph to Options 3, Section 7.

²⁹⁴ See Supplementary Material .02(d)(3) to Options 3, Section 7.

²⁹⁵ See *supra* note 81.

²⁹⁶ See Cboe Rule 5.71. See *supra* note 83.

Section 10 is consistent with the FLEX rules of other options exchanges that similarly do not contemplate the interaction of their respective order books with FLEX transactions.²⁹⁷

L. FLEX Options Trading (Section 11)

The Exchange believes that proposed Section 11(a), which specifies the requirements for submitting FLEX Orders for trading, is consistent with the Act. Proposed Section 11(a) will set forth which mechanisms would be available for FLEX Orders (*i.e.*, electronic FLEX Auction, FLEX PIM, or FLEX SOM) and the order entry requirements for simple and complex FLEX Orders. As noted above, these provisions will be substantially similar to the FLEX rules of other options exchanges.²⁹⁸ The Exchange believes that System-enforcing the stipulation that it will not accept simple or complex FLEX Orders if the order or leg, as applicable, has identical terms as a non-FLEX Option series that is already listed for trading will prevent options with the same terms to trade as both a FLEX Options and non-FLEX Option, thereby eliminating any potential concerns around inconsistent order handling.

The Exchange believes that the electronic FLEX Auction as described in proposed Section 11(b) will remove impediments to and perfect the mechanism of a free and open market, and protect investors and the public interest. The proposed FLEX Auction will offer market participants with an auction mechanism for the execution of FLEX Options at potentially improved prices that is substantially similar in all respects to Cboe Rule 5.72(c), except for certain intended differences to align to current auction functionality in order to allow the proposed FLEX Auction to fit more seamlessly into the Exchange's market. For instance, the Exchange will not allow prices to be expressed as percentages in the electronic FLEX Auction as it does not have this capability today. The Exchange will also follow current non-FLEX auction behavior by allowing the FLEX Auction to end at the market close with an execution (if an execution is permitted pursuant to proposed Section 11(b)) in the event the designated exposure interval exceeds the market close.²⁹⁹ In doing so, the Exchange's proposal will

promote executions in electronic FLEX Auctions (instead of cancelling the FLEX Order) while also preventing executions after the market close. The Exchange will also align the minimum increment requirements in proposed Section 11(b)(1)(G) for stock-tied FLEX complex strategies with its existing requirements for stock-tied non-FLEX complex strategies in Options 3, Section 14(c)(1). Furthermore, pursuant to proposed Section 11(b)(2)(D), the Exchange would not allow Members to submit multiple FLEX responses using the same badge/mnemonic and would also not aggregate all of those responses at the same price in order to align to current auction functionality for non-FLEX Orders. Additionally, the Exchange will also specify in proposed Section 11(b)(2)(D) that an additional FLEX response from the same badge/mnemonic for the same auction ID will automatically replace the previous FLEX response.³⁰⁰ The Exchange will also align the proposed FLEX Auction allocation methodology (*i.e.*, Priority Customer Size Pro-Rata and one contract allocation)³⁰¹ and related rounding (*i.e.*, rounding up for the higher response quantity)³⁰² with current auction functionality in those respects.³⁰³ The Exchange believes that the proposed priority and allocation rules for the FLEX Auction will ensure a fair and orderly market by maintaining the priority of orders and protecting Priority Customer orders, while still affording the opportunity for price improvement during each FLEX Auction commenced on the Exchange. As noted above, all of the foregoing features are harmonized with the Exchange's current auction functionality for non-FLEX Orders, including PIM and SOM, so the Exchange believes that this will promote consistency for Members participating across different auctions on ISE.

Furthermore, unlike Cboe, the Exchange will not include certain details in the proposed FLEX Auction notification message in proposed Section 11(b)(2)(A) like what time the auction will conclude or whether the

FLEX Order is Attributable. For simplicity, the Exchange will instead disseminate the duration of the exposure interval, instead of calculating and disseminating what time the auction will conclude, and will not offer an Attributable designation for FLEX Orders.

Otherwise, the general framework of the proposed electronic FLEX Auction in Section 11(b) (such as the eligibility requirements, the auction process and conclusion, and execution provisions) is consistent with the framework for Cboe's electronic FLEX Auctions in Cboe Rule 5.72(c). The clarity in how the proposed FLEX Auction will function and its consistency with similar auctions at another exchange will help promote a fair and orderly national options market system.

Like Cboe, the Exchange believes that the proposed auction exposure interval periods strike an appropriate balance between allowing executions of FLEX Orders to be completed in a timely fashion and providing Members sufficient time to price the unique terms of FLEX Options. As noted above, the submitting Member must designate the length of the exposure interval (which will be included in the auction notification message) to be between three seconds and five minutes, which is identical to Cboe's range of exposure intervals for their electronic FLEX Auctions in Cboe Rule 5.72(c)(1)(F). The Exchange believes it is appropriate to require the submitting Member to establish the length of the auction period (which will be included in the auction notification message), as the Member is in the best position to determine a reasonable period of time to provide other Members to respond based on the complexity of the FLEX Option series that is the subject of the auction, as well as based on market conditions (for example, in a volatile market, the Member may believe it is in the best interests of a customer to have a shorter auction period given quickly changing prices).

The Exchange believes that the proposed rule change to allow multiple electronic FLEX Auctions overlap will benefit investors, as it may lead to an increase in Exchange volume and permit the Exchange to compete with the OTC market, while providing for additional opportunities for price discovery and execution. Although electronic FLEX Auctions will be allowed to overlap, the Exchange does not believe that this raises any issues that are not addressed through the proposal as described above. For example, although overlapping, each auction will be started in a sequence

²⁹⁷ See *supra* note 89.

²⁹⁸ In particular, proposed Options 3A, Section 11(a) is based on Cboe Rule 5.72(b) and BOX Rule 7605(d). See *supra* notes 90–92 and note 94.

²⁹⁹ See proposed Options 3A, Section 11(b)(1)(F). While the current rules are silent in this regard, the Exchange notes that its proposal will follow current SOM and PIM behavior. See *generally* Options 3, Sections 11(d) and 13.

³⁰⁰ While this behavior is not specified in the Exchange's current rules, auction responses are currently handled in the same manner for SOM and PIM. See *generally* Options 3, Sections 11(d)(2) and 13(c).

³⁰¹ See proposed Options 3A, Sections 11(b)(3)(A)(i) and (iii).

³⁰² See proposed Options 3A, Sections 11(b)(3)(A)(ii).

³⁰³ See, *e.g.*, Options 3, Section 11(d)(3)(C) (SOM allocation methodology); Options 3, Section 13(d) (PIM allocation methodology); Supplementary Material .09 to Options 3, Section 11; and Supplementary Material .10 to Options 3, Section 13.

and with a time that will determine its processing. Thus, even if there are two auctions that commence and conclude, at nearly the same time, each auction will have a distinct conclusion at which time the auction will be allocated. Additionally, FLEX Orders submitted into an electronic FLEX Auction will be able to execute only against FLEX responses submitted to that auction. If market participants desire to have interest execute against both FLEX Orders subject to concurrent FLEX Auctions, market participants may submit responses to both auctions. Additionally, the proposed concurrent auction feature is materially identical to Cboe's electronic FLEX Auction feature in Cboe Rule 5.72(c)(2)(B).

M. FLEX PIM and FLEX SOM (Sections 12 and 13)

The Exchange believes that the FLEX PIM and FLEX SOM Auctions as described in proposed Sections 12 and 13, respectively, will remove impediments to and perfect the mechanism of a free and open market, and protect investors and the public interest. The proposed FLEX PIM and FLEX SOM Auctions will offer market participants with auction mechanisms for the execution of FLEX Options at potentially improved prices that are substantially similar to Cboe's FLEX AIM and FLEX SAM set forth in Cboe Rule 5.73 and 5.74, respectively, except for certain intended differences to align to the Exchange's current PIM and SOM auction functionality to allow the proposed FLEX PIM and SOM Auctions to fit more seamlessly into the Exchange's market. For instance, the Exchange will not allow prices to be expressed as percentages in FLEX PIM or FLEX SOM as it does not have this capability today. For FLEX SOM, the Exchange will not allow the Solicited Order to be comprised of multiple solicited orders in FLEX SOM to be consistent with current non-FLEX SOM functionality in Options 3, Section 11(d). The Exchange will also align the minimum increment requirements for stock-tied FLEX complex strategies submitted into FLEX PIM or FLEX SOM with its existing requirements for stock-tied non-FLEX complex strategies in Options 3, Section 14(c)(1). The Exchange will also follow current non-FLEX PIM and SOM behavior by allowing the FLEX PIM or FLEX SOM Auction to end at the market close with an execution (if an execution is permitted pursuant to proposed Section 12 or Section 13, as applicable) in the event the designated length of the auction period exceeds the market

close.³⁰⁴ In doing so, the Exchange's proposal will promote executions in FLEX PIM and FLEX SOM (instead of cancelling the FLEX Order) while also preventing executions after the market close. Furthermore, pursuant to Sections 12(c)(5)(B) and 13(c)(5)(B) (as applicable), the Exchange would not allow Members to submit multiple FLEX PIM or FLEX SOM responses using the same badge/mnemonic and would also not aggregate all of those responses at the same price in order to align to current PIM and SOM functionality for non-FLEX Orders. Additionally, the Exchange will also specify that an additional FLEX PIM or SOM response from the same badge/mnemonic for the same auction ID will automatically replace the previous FLEX PIM or SOM response.³⁰⁵ The Exchange will also align to current PIM functionality by allowing a limited exception to the restriction in proposed Section 12(c)(4) against modifying or canceling a FLEX PIM Agency Order or Initiating Order by allowing Initiating Members to improve the price of their Initiating Orders.³⁰⁶ The Exchange will also align to current SOM functionality by allowing Initiating Members to cancel (but not modify) their FLEX SOM Agency Orders and Solicited Orders pursuant to proposed Section 13(c)(4).³⁰⁷

The Exchange will also align certain aspects of the proposed FLEX PIM allocation methodology with its current non-FLEX PIM allocation methodology. First, the Exchange will base the allocation percentages set forth in proposed Section 12(e)(1)(B)(ii) on the original size of the Agency Order, instead of the number of contract remaining after execution against Priority Customer responses like Cboe Rule 5.73(e)(1)(B)(ii). As noted above, this will align to current PIM behavior in Options 3, Section 13(d)(3). Second, the Exchange will specify two limited scenarios in proposed Section 12(e)(1)(B) where the Initiating Member could receive an allocation percentage that is greater than the Initiating Member's guaranteed allocation (*i.e.*,

³⁰⁴ See proposed Options 3A, Sections 12(c)(3) and 13(c)(3). While the current rules are silent in this regard, the Exchange notes that its proposal will follow current SOM and PIM behavior. See generally Options 3, Sections 11(d) and 13.

³⁰⁵ While this behavior is not specified in the Exchange's current rules, auction responses are currently handled in the same manner for SOM and PIM. See generally Options 3, Sections 11(d)(2) and 13(c).

³⁰⁶ See *supra* note 138 and accompanying text.

³⁰⁷ As noted above, while this feature is not explicitly stated in the current SOM rules in Options 3, Section 13(d), it is consistent with current SOM functionality.

when there are remaining contracts after including all PIM responses or when rounding up). As noted above, while Cboe does not have these exceptions noted in Cboe Rule 5.73(e)(1)(B), this will be consistent with current PIM behavior.³⁰⁸ Third, the Exchange will specify in proposed Section 12(e)(2)(B) that other FLEX PIM responses at prices better than the final auction price will be allocated in time priority and all other FLEX PIM responses at the final auction price will be allocated on a Size Pro-Rata Basis.³⁰⁹ Fourth, the Exchange will replace Cboe's last priority allocation in Cboe Rule 5.73(e)(4) with a guaranteed allocation feature in proposed Section 12(e)(4), which will be similar to a current PIM feature currently in Options 3, Section 13(d)(3) that allows Members to request a lower percentage than their guaranteed allocation.³¹⁰ For both FLEX PIM and FLEX SOM, the Exchange will also specify that if an allocation would result in less than one contract, then one contract will be allocated.³¹¹ This would align to current SOM and PIM allocation.³¹² As noted above, all of the foregoing features are consistent with the Exchange's current PIM and SOM auction functionality for non-FLEX Orders, so the Exchange believes that this will promote consistency for Members participating across different auctions on ISE.

As it relates to FLEX PIM's proposed guaranteed allocation percentages of 50% (if there is a response(s) from one other Member) or 40% (if there are responses from two or more Members), these percentages will align to other options exchanges as noted above.³¹³ While the foregoing percentages for FLEX PIM differ from the current guaranteed allocation percentage of 40% for the Exchange's non-FLEX PIM, the Exchange does not believe that this percentage difference will put market participants using one type of PIM auction (*i.e.*, FLEX versus non-FLEX PIM) on ISE at a competitive disadvantage against market participants using the other PIM auction type. FLEX PIM is a separate auction functionality and can only be used for FLEX Options. Once a FLEX Option series becomes fully fungible with an identical non-FLEX Option series, that

³⁰⁸ See *supra* note 151.

³⁰⁹ See *supra* note 155.

³¹⁰ See *supra* note 158.

³¹¹ See proposed Supplementary Material .03 to Options 3A, Section 11 and Supplementary Material .03 to Options 3A, Section 12.

³¹² See Supplementary Material .09 to Options 3, Section 11 and Supplementary Material .10 to Options 3, Section 13).

³¹³ See *supra* note 158.

non-FLEX Option series can no longer be submitted into a FLEX PIM auction and must instead be entered into one of the Exchange's other auction mechanisms (such as standard PIM) if the market participant desires to utilize an auction mechanism. Furthermore, the FLEX market is unique in that there is no order book, no opening, and no quoting versus its standard non-FLEX market which has all of those features and therefore has a myriad of other ways in which market participants may access liquidity. The Exchange therefore does not believe offering a different guaranteed allocation percentage for its FLEX PIM would place market participants using non-FLEX PIM at a competitive disadvantage given the reasons set out above.

Otherwise, the general frameworks of the proposed FLEX PIM and FLEX SOM Auctions in Sections 12 and 13 (such as the eligibility requirements, stop price requirements, auction process and conclusion, and execution provisions) are consistent with the frameworks for Cboe's FLEX AIM and FLEX SAM in Cboe Rules 5.73 and 5.74, respectively. The clarity in how FLEX PIM and FLEX SOM will function and their consistency with similar auctions at another exchange will help promote a fair and orderly national options market system. For example, the proposed range for the length of each of the FLEX PIM and FLEX SOM Auction periods is consistent with the range for the auction periods of the Cboe's FLEX AIM and FLEX SAM Auctions in Cboe Rules 5.73(c)(3) and 5.74(c)(3), respectively. Like Cboe, the Exchange believes it is appropriate to provide a reasonable and sufficient amount of time in which market participants may submit responses because of the unique terms of FLEX Options. Therefore, the Exchange is proposing that the minimum length of a FLEX PIM or FLEX SOM Auction be three seconds. The Exchange also proposes a maximum length of an auction period to be five minutes, as the Exchange also believes it is appropriate to provide for efficient and timely executions so that customers do not potentially miss a market. The proposed rule change also requires the Initiating Member to establish the length of the auction period (which will be included in the auction notification message), as the Member is in the best position to determine a reasonable period of time to provide other Members to respond based on the complexity of the FLEX Option series that is the subject of the auction, as well as based on market conditions (for example, in a volatile market, the Member may

believe it is in the best interests of a customer to have a shorter auction period given quickly changing prices).

The proposal will also allow FLEX PIM and FLEX SOM Auctions to occur concurrently with other FLEX PIM and FLEX SOM Auctions. As discussed above, the Exchange is aligning with current Cboe FLEX AIM and FLEX SAM behavior in Cboe Rules 5.73(c)(1) and 5.74(c)(1), respectively. Like Cboe, the Exchange does not believe that allowing FLEX PIM and FLEX SOM Auctions to overlap would raise any issues that are not addressed by proposal. For example, although overlapping, each FLEX PIM or FLEX SOM Auction will be started in a sequence and with a duration that determines its processing. Thus, even if there are two FLEX PIM or FLEX SOM Auctions that commence and conclude, at nearly the same time, each Auction will have a distinct conclusion at which time the Auction will be allocated, and only against responses submitted into that Auction. As discussed above, each FLEX PIM or FLEX SOM response is required to specifically identify the FLEX PIM or FLEX SOM Auction, respectively, for which it is targeted and if not fully executed, will be cancelled back at the conclusion of the Auction. Thus, responses will be specifically considered and executed only in the specified Auction. As a general matter, issues with concurrent auctions can relate to the interaction of auctioned orders with contra-side interest resting on the book at the end of various auctions. As noted above, there will be no order book available for FLEX trading, so there can be no conflict among contra-side interest resting on the book and FLEX PIM or FLEX SOM responses with respect to executions. Further, because there is no book for FLEX Options, there are no events that cause a FLEX PIM or FLEX SOM to conclude prior to the end of auction exposure period that would result in an execution, and therefore, the same event could not cause multiple auctions to conclude early.

Like Cboe, the Exchange will apply a Size Pro-Rata execution algorithm with a Priority Customer overlay for FLEX PIM and FLEX SOM.³¹⁴ The Exchange believes that the proposed priority and allocation rules for FLEX PIM and FLEX SOM will ensure a fair and orderly market by maintaining the priority of orders and protecting Priority Customer orders, while still affording the

³¹⁴ See proposed Options 3A, Sections 12(e) and 13(e). As noted above, this is also consistent with the Exchange's current priority and allocation methodology for non-FLEX auctions, including SOM and PIM. See Options 3, Section 11(d)(3)(C) and Section 13(d).

opportunity for price improvement during each FLEX PIM and FLEX SOM Auction commenced on the Exchange.

N. Risk Protections (Section 14)

The Exchange believes that specifying the risk protections in proposed Options 3A, Section 14 will benefit investors with additional transparency regarding which of the Exchange's risk protections in Options 3, Sections 15 (simple order risk protections), 16 (complex order risk protections), and 28 (optional risk protections) would apply to FLEX trading. The Exchange also believes that applying the foregoing risk protections to FLEX Options will protect investors and the public interest, and maintain fair and orderly markets, by providing market participants with more tools to manage their risk. In addition, providing Members with more tools for managing risk facilitates transactions in FLEX Options because Members will have more confidence that risk protections are in place. As a result, apply the foregoing risk protections has the potential to promote just and equitable principles of trade.

O. Data Feeds (Section 15)

The Exchange believes that specifying the data feeds in proposed Options 3A, Section 15 will benefit investors with additional transparency regarding which data feeds it will disseminate auction notifications for simple and complex FLEX Orders. As discussed above, the Exchange proposes to disseminate auction notifications for simple FLEX Orders through the Order Feed and auction notifications for complex FLEX Orders through the Spread Feed, which will be consistent with how non-FLEX simple and complex auction notifications are disseminated today.

P. FLEX Market Makers and Letters of Guarantee (Sections 16 and 17)

The Exchange believes that the proposed FLEX Market Maker provisions in Section 16 will provide clarity and transparency as to how FLEX Market Makers are appointed and their related obligations. As noted above, these provisions are substantially similar to other options exchanges, notably Cboe and Phlx.³¹⁵

Pursuant to proposed Section 17, the Exchange will ensure that all FLEX transactions effected by FLEX Market Makers will be covered by an effective Letter of Guarantee.³¹⁶ The Exchange

³¹⁵ See *supra* notes 211–214.

³¹⁶ Today, all ISE Market Makers are required to enter into a Letter of Guarantee pursuant to Options 6, Section 4. Cboe Rule 3.61(e) separately requires FLEX Market Makers to provide a Letter of

believes that the Letter of Guarantee will protect investors and the public interest because it signifies that the clearing member has accepted financial responsibility for transactions in all options entered into by the Market Maker, which will protect the counterparties of those trades and such protections will flow to other clearing members and ultimately to the OCC as the central counterparty and guarantor of both FLEX and non-FLEX Option transactions. The Exchange will notify all clearing members of the new FLEX rules to confirm that all clearing members' Letters of Guarantee will cover all financial responsibilities for all FLEX transactions by FLEX Market Makers, and will require additions to their effective Letters of Guarantee to provide full coverage, where necessary. The Exchange believes this will ensure that all FLEX Market Makers will be covered by effective Letters of Guarantee for their FLEX transactions.

Q. Position and Exercise Limits (Sections 18 and 19)

Position and exercise limits are designed to address potential manipulative schemes and adverse market impacts surrounding the use of options, such as disrupting the market in the security underlying the options. While position and exercise limits should address and discourage the potential for manipulative schemes and adverse market impact, if such limits are set too low, participation in the options market may be discouraged. The Exchange believes that any decision regarding imposing position and exercise limits for FLEX Options must therefore be balanced between mitigating concerns of any potential manipulation and the cost of inhibiting potential hedging activity that could be used for legitimate economic purposes.

As it relates to FLEX Index Options, the Exchange believes that the proposed position and exercise limits in Sections 18(a), 18(c), and 19(a) are reasonably designed to prevent a Member from using FLEX Index Options to evade the

Guarantee issued by a clearing member and filed with the Exchange accepting responsibility for all FLEX transactions made by the FLEX Market Maker.

position limits applicable to comparable non-FLEX Index Options. Further, by establishing the proposed position and exercise limits for FLEX Index Options and, importantly, aggregating such positions in the manner described in proposed Sections 18(c)(1), (c)(2), and 19(a)(3), the Exchange believes that the position and exercise limit requirements for FLEX Index Options should help to ensure that the trading of FLEX Index Options would not increase the potential for manipulation or market disruption and could help to minimize such incentives. The Exchange also notes that proposed position and exercise limits are consistent with the rules of another options exchanges that offer FLEX Index Options, as well as the rules of its own standard non-FLEX index options market, and therefore raise no novel issues for the Commission.³¹⁷

As it relates to FLEX Equity Options, while no position limits are proposed for FLEX Equity Options, there are several mitigating factors, which include aggregation of FLEX Equity Option and non-FLEX Equity Option positions that expire on a third Friday-of-the-month and subjecting those positions to position and exercise limits, and daily monitoring of market activity. Similar to the other exchanges that trade FLEX Equity Options, the Exchange believes that eliminating position and exercise limits for FLEX Equity Options, while requiring positions in FLEX Equity Options that expire on a third Friday-of-the-month to be aggregated with positions in non-FLEX Equity Options on the same underlying security,³¹⁸ removes impediments to and perfects the mechanism of a free and open market and a national market system because it allow the Exchange to create a product and market that is an improved but comparable alternative to the OTC market in customized options. OTC transactions occur through

³¹⁷ See Cboe Rules 8.35(a), (b), (d), and 8.42(g) and ISE Options 4A, Sections 6(a), 7(a)(1), 9(a)(13), and 9(a)(14).

³¹⁸ See proposed Options 3A, Section 18(c)(3) and Section 19(a)(3). See also Cboe Rules 8.35(d)(3) and 8.42(g)(3); NYSE Arca Rules 5.35-O(a)(iii), (b) and 5.36-O; NYSE American Rules 906G and 907G; and Phlx Options 8, Section 34(e) and (f).

bilateral agreements, the terms of which are not publicly disclosed to the marketplace. As such, OTC transactions do not contribute to the price discovery process that exists on a public exchange.

The Exchange believes that the proposed elimination of position and exercise limits for FLEX Equity Options may encourage market participants to transfer their liquidity demands from OTC markets to exchanges and enable liquidity providers to provide additional liquidity to ISE through transactions in FLEX Equity Options. The Exchange notes that the Commission previously approved the elimination of position and exercise limits for FLEX Equity Options, finding that such elimination would allow exchanges "to better compete with the growing OTC market in customized equity options, thereby encouraging fair competition among brokers and dealers and exchange markets."³¹⁹ The Commission has also stated that the elimination of position and exercise limits for FLEX Equity Options "could potentially expand the depth and liquidity of the FLEX equity market without significantly increasing concerns regarding intermarket manipulations or disruptions of the options or the underlying securities."³²⁰

Additionally, the Exchange believes that requiring positions in FLEX Equity Options that expire on a third Friday-of-the-month to be aggregated with positions in non-FLEX Equity Options on the same underlying security subjects FLEX Equity Options and non-FLEX Equity Options to the same position and exercise limits on third Friday-of-the-month expirations. These limitations are intended to serve as a safeguard against potential adverse effects of large FLEX Equity Option positions expiring on the same day as non-FLEX Equity Option positions. As noted above, Cboe Rules 8.35(d)(3) and 8.42(g)(3) have the same requirements.

³¹⁹ See Securities Exchange Act Release No. 42223 (December 10, 1999), 64 FR 71158, 71159 (December 20, 1999) (SR-Amex-99-40) (SR-PCX-99-41) (SR-CBOE-99-59) (Order Granting Accelerated Approval to Proposed Rule Change Relating to the Permanent Approval of the Elimination of Position and Exercise Limits for FLEX Equity Options).

³²⁰ See *id.*

The Exchange believes that any potential risk of manipulative activity is mitigated by existing surveillance technologies, procedures, and reporting requirements at the Exchange, which allows the Exchange to properly identify disruptive and/or manipulative trading activity. In addition to its own surveillance programs, the Exchange also works with other SROs and exchanges on intermarket surveillance related issues. Through its participation in ISG, the Exchange shares information and coordinates inquiries and investigations with other exchanges designed to address potential intermarket manipulation and trading abuses. The Exchange also notes that FINRA conducts cross-market surveillances on behalf of the Exchange pursuant to a regulatory services agreement.³²¹ The Exchange also represents that it is reviewing its procedures to detect potential manipulation in light of any changes required for FLEX Options to confirm appropriate surveillance coverage and would make any changes that the Exchange believes are necessary for FLEX trading. These procedures utilize daily monitoring of market activity via automated surveillance techniques to identify unusual activity in both options and their underlying securities and are designed to protect investors and the public interest by ensuring that the Exchange has an adequate surveillance program in place.

The Exchange believes that proposed Section 18(b)(2) and (3) further mitigates concerns for potential market manipulation and/or disruption in the underlying markets and thus protects investors and the public interest because position reporting will be required (other than for a Market Maker) and the Exchange may determine that a higher margin requirement is necessary in light of the risks associated with a FLEX Equity Option position in excess of the standard limit for non-FLEX Equity Options of the same class. The Exchange may, pursuant to its authority under Options 6C, Section 5, impose additional margin upon the account maintaining such under-hedged position as a safeguard against potential adverse effects of large FLEX Equity Option positions. The Exchange notes that the clearing firm carrying the account will be subject to capital charges under SEC Rule 15c3-1 to the extent of any margin deficiency resulting from a higher margin requirement imposed by the Exchange.

Lastly, the Exchange notes that other exchanges currently trading FLEX options have similar position and exercise limits described above.³²²

R. Cash-Settled FLEX ETF Options

Introducing cash-settled FLEX ETF Options will increase order flow to the Exchange, increase the variety of options products available for trading, and provide a valuable tool for investors to manage risk.

The Exchange believes that the proposal to permit cash settlement as a contract term for options on the specified group of equity securities would remove impediments to and perfect the mechanism of a free and open market as cash-settled FLEX ETF Options would enable market participants to receive cash in lieu of shares of the underlying security, which would, in turn provide greater opportunities for market participants to manage risk through the use of a cash-settled product to the benefit of investors and the public interest. The Exchange does not believe that allowing cash settlement as a contract term for options on the specified group of equity securities would render the marketplace for equity options more susceptible to manipulative practices. As illustrated in the table above, each of the qualifying underlying securities is actively traded and highly liquid and thus would not be susceptible to manipulation because, over a six-month period, each security had an average daily notional value of at least \$500 million and an ADV of at least 4,680,000 shares, which indicates that there is substantial liquidity present in the trading of these securities, and that there is significant depth and breadth of market participants providing liquidity and of investor interest. The Exchange believes the proposed bi-annual review to determine eligibility for an underlying ETF to have cash settlement as a contract term would remove impediments to and perfect the mechanism of a free and open market as it would permit the Exchange to select only those underlying ETFs that are actively traded and have robust liquidity as each qualifying ETF would be required to meet the average daily notional value and average daily volume requirements, as well as to select the same underlying ETFs on which other exchanges may list cash-settled FLEX ETF Options.³²³

The Exchange believes the proposed change that, for FLEX ETF Options, at least one of exercise style, expiration

date, and exercise price must differ from options in the non-FLEX market will provide clarity and eliminate confusion regarding permissible terms of FLEX ETF Options, including the proposed cash-settled FLEX ETF Options.

The Exchange believes that the data provided by the Exchange supports the supposition that permitting cash settlement as a FLEX term for the 46 underlying ETFs that would currently qualify to have cash settlement as a contract term would broaden the base of investors that use FLEX Equity Options to manage their trading and investment risk, including investors that currently trade in the OTC market for customized options, where settlement restrictions do not apply.

The Exchange believes that the proposal to permit cash settlement for certain FLEX ETF options would remove impediments to and perfect the mechanism of a free and open market because the proposed rule change would provide members and member organizations with enhanced methods to manage risk by receiving cash if they choose to do so instead of the underlying security. In addition, this proposal would promote just and equitable principles of trade and protect investors and the general public because cash settlement would provide investors with an additional tool to manage their risk. Further, the Exchange notes that another exchange has previously received approval that allows for the trading of cash-settled options, and, specifically, cash-settled FLEX ETF Options in an identical manner as the Exchange proposes to list them pursuant to this rule filing.³²⁴ The proposed rule change therefore should not raise issues for the Commission that it has not previously addressed.

The proposed rule change to permit cash settlement as a contract term for options on up to 50 ETFs is designed to promote just and equitable principles of trade in that the availability of cash settlement as a contract term would give market participants an alternative to trading similar products in the OTC market. By trading a product in an exchange-traded environment (that is currently traded in the OTC market), the Exchange would be able to compete more effectively with the OTC market. The Exchange believes the proposed rule change is designed to prevent fraudulent and manipulative acts and practices in that it would lead to the migration of options currently trading in the OTC market to trading on the Exchange. Also, any migration to the Exchange from the OTC market would

³²¹ The Exchange notes that it is responsible for FINRA's performance under this regulatory services agreement.

³²² See Cboe Rules 8.35(d) and 8.42(g); and Phlx Options 8, Section 34(e) and (f).

³²³ See *supra* notes 243 and 244.

³²⁴ See *supra* notes 243 and 244.

result in increased market transparency. Additionally, the Exchange believes the proposed rule change is designed to remove impediments to and to perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest in that it should create greater trading and hedging opportunities and flexibility. The proposed rule change should also result in enhanced efficiency in initiating and closing out positions and heightened contra-party creditworthiness due to the role of OCC as issuer and guarantor of the proposed cash-settled options. Further, the proposed rule change would result in increased competition by permitting the Exchange to offer products that are currently available for trading only in the OTC market and are approved to trade on another options exchange.

The Exchange believes that establishing position limits for cash-settled FLEX ETF Options to be the same as physically settled options on the same underlying security, and aggregating positions in cash-settled FLEX ETF Options with physically settled options on the same underlying security for purposes of calculating position limits is reasonable and consistent with the Act. By establishing the same position limits for cash-settled FLEX ETF Options as for physically settled options on the same underlying security and, importantly, aggregating such positions, the Exchange believes that the position limit requirements for cash-settled FLEX ETF Options should help to ensure that the trading of cash-settled FLEX ETF Options would not increase the potential for manipulation or market disruption and could help to minimize such incentives. For the same reasons, the Exchange believes the proposed exercise limits are reasonable and consistent with the Act.

Finally, the Exchange represents that it has an adequate surveillance program in place to detect manipulative trading in cash-settled FLEX ETF Options and the underlying ETFs. Regarding the proposed cash settlement, the Exchange would use the same surveillance procedures currently utilized for the Exchange's other FLEX Options. For surveillance purposes, the Exchange would have access to information regarding trading activity in the pertinent underlying ETFs. The Exchange believes that limiting cash settlement to no more than 50 underlying ETFs (currently, 46 ETFs would be eligible to have cash-settlement as a contract term) would minimize the possibility of manipulation due to the robust liquidity

in both the equities and options markets.

As a self-regulatory organization, the Exchange recognizes the importance of surveillance, among other things, to detect and deter fraudulent and manipulative trading activity as well as other violations of Exchange rules and the federal securities laws. As discussed above, ISE has adequate surveillance procedures in place to monitor trading in cash-settled FLEX ETF Options and the underlying securities, including to detect manipulative trading activity in both the options and the underlying ETF.³²⁵ The Exchange further notes the liquidity and active markets in the underlying ETFs, and the high number of market participants in both the underlying ETFs and existing options on the ETFs, helps to minimize the possibility of manipulation. The Exchange further notes that under Section 19(g) of the Act, the Exchange, as a self-regulatory organization, is required to enforce compliance by its members and persons associated with its members with the Act, the rules and regulations thereunder, and the rules of the Exchange.³²⁶ The Exchange believes its surveillance, along with the liquidity criteria and position and exercise limits requirements, are reasonably designed to mitigate manipulation and market disruption concerns and will permit it to enforce compliance with the proposed rules and other Exchange rules in accordance with Section 19(g) of the Act. The Exchange performs ongoing evaluations of its surveillance program to ensure its continued effectiveness and will continue to review its surveillance procedures on an ongoing basis and make any necessary enhancements and/or modifications that may be needed for the cash settlement of FLEX ETF Options.

Additionally, the Exchange will monitor any effect additional options series listed under the proposed rule change will have on market

³²⁵ Among other things, ISE's regulatory program include cross-market surveillance designed to identify manipulative and other improper trading, including spoofing, algorithm gaming, marking the close and open, as well as more general abusive behavior related to front running, wash sales, and quoting/routing, which may occur on the Exchange and other markets. Furthermore, the Exchange stated that it has access to information regarding trading activity in the pertinent underlying securities as a member of ISG. As it relates to Reg SHO violations, the Exchange will enforce this through its Stock-Tied Reg SHO price protections in Options 3, Section 16(e). See *supra* note 205 for Stock-Tied Reg SHO discussion. NES will only execute Stock-Option Strategies and Stock-Complex Strategies if the underlying covered security component is in accordance with Rule 201 of Regulation SHO.

³²⁶ 15 U.S.C. 78s(g).

fragmentation and the capacity of the Exchange's automated systems. The Exchange will take prompt action, including timely communication with the Commission and with other self-regulatory organizations responsible for oversight of trading in options, the underlying ETFs, and the ETFs' component securities, should any unanticipated adverse market effects develop.

S. Section 11(a) Analysis

The Exchange believes that the proposed FLEX rules in Options 3A, including the proposed electronic FLEX Auction in Options 3A, Section 11(b), proposed FLEX PIM in Options 3A, Section 12, and proposed FLEX SOM in Options 3A, Section 13, are consistent with Section 11(a)(1) of the Act³²⁷ and the rules promulgated thereunder. Generally, Section 11(a)(1) of the Act restricts any member of a national securities exchange from effecting any transaction on such exchange for (i) the member's own account, (ii) the account of a person associated with the member, or (iii) an account over which the member or a person associated with the member exercises investment discretion (collectively referred to as "covered accounts"), unless a specific exemption is available. Examples of common exemptions include the exemption for transactions by broker dealers acting in the capacity of a market maker under Section 11(a)(1)(A),³²⁸ the "G" exemption for yielding priority to non-members under Section 11(a)(1)(G) of the Act and Rule 11a1-1(T) thereunder,³²⁹ and the "Effect vs. Execute" exemption under Rule 11a2-2(T) under the Act.³³⁰ The "Effect vs. Execute" exemption permits an exchange member, subject to certain conditions, to effect transactions for covered accounts by arranging for an unaffiliated member to execute transactions on the exchange. To comply with Rule 11a2-2(T)'s conditions, a member: (i) must transmit the order from off the exchange floor; (ii) may not participate in the execution of the transaction once it has been transmitted to the member performing

³²⁷ 15 U.S.C. 78k(a). Section 11(a)(1) prohibits a member of a national securities exchange from effecting transactions on that exchange for its own account, the account of an associated person, or an account over which it or its associated person exercises investment discretion unless an exception applies.

³²⁸ 15 U.S.C. 78k(a)(1)(A).

³²⁹ 15 U.S.C. 78k(a)(1)(G) and 17 CFR 240.11a1-1(T).

³³⁰ 17 CFR 240.11a2-2(T).

the execution;³³¹ (iii) may not be affiliated with the executing member; and (iv) with respect to an account over which the member has investment discretion, neither the member nor its associated person may retain any compensation in connection with effecting the transaction except as provided in the Rule. For the reasons set forth below, the Exchange believes that Members entering orders and responses into the electronic FLEX Auction pursuant to proposed Options 3A, Section 11(b), FLEX PIM pursuant to proposed Options 3A, Section 12, and FLEX SOM pursuant to proposed Options 3A, Section 13 would satisfy the requirements of Rule 11a2-2(T).

Rule 11a2-2(T)'s first requirement is that orders for covered accounts be transmitted from off the exchange floor. The Exchange does not operate a physical trading floor. In the context of automated trading systems, the Commission has found that the off-floor transmission requirement is met if a covered account order is transmitted from a remote location directly to an exchange's floor by electronic means.³³² The Exchange represents that the System and the proposed FLEX auction mechanisms described above will receive all FLEX Orders and FLEX responses electronically through remote terminals or computer-to-computer interfaces. The Exchange represents that FLEX Orders and FLEX responses for covered accounts from Members will be transmitted from a remote location directly to the proposed FLEX auction mechanisms described above by electronic means.

The second condition of Rule 11a2-2(T) requires that neither a member nor an associated person participate in the execution of its order once the order is transmitted to the floor for execution. The Exchange represents that, upon submission to the FLEX Auction, FLEX

PIM, or FLEX SOM, a FLEX Order or FLEX response will be executed automatically pursuant to the rules set forth in proposed Options 3A, Section 11(b) (for FLEX Auctions), Section 12 (for FLEX PIM), and Section 13 (for FLEX SOM). In particular, execution of a FLEX Order (including the Agency and the Initiating or Solicited Order, as applicable) or a FLEX response sent to the applicable auction mechanism depends not on the Member entering the FLEX Order or FLEX response, but rather on what other FLEX responses are present and the priority of those FLEX responses. Thus, at no time following the submission of a FLEX Order or FLEX response is a Member or any associated person of such Member able to acquire control or influence over the result or timing of the FLEX Order or FLEX response execution.³³³ Once the FLEX Order (including the Agency Order and Initiating or Solicited Order (as applicable)) has been transmitted, the Member that transmitted such order into the FLEX Auction, FLEX PIM, or FLEX SOM (as applicable) will not participate in the execution of the FLEX Order. Members submitting the FLEX Orders (including the Agency Orders and Initiating or Solicited Orders (as applicable)) into the applicable FLEX auction mechanisms will relinquish control to cancel their FLEX Orders entered into the FLEX Auction, or modify or cancel their Agency Orders and Initiating or Solicited Orders (as applicable) entered into FLEX PIM and FLEX SOM.³³⁴ Further, no Member, including the Member submitting the FLEX Order into the applicable FLEX auction mechanisms described above, will see FLEX responses submitted into

any of the FLEX auction mechanisms and therefore will not be able to influence or guide the execution of their FLEX Orders or FLEX responses, as applicable.

Rule 11a2-2(T)'s third condition requires that the order be executed by an exchange member who is unaffiliated with the member initiating the order. The Commission has stated that the requirement is satisfied when automated exchange facilities, such as the FLEX Auction, FLEX PIM, and FLEX SOM are used, as long as the design of these systems ensures that members do not possess any special or unique trading advantages in handling their orders after transmitting them to the exchange.³³⁵ The Exchange represents that the FLEX Auction, FLEX PIM, and FLEX SOM are designed so that no Member has any special or unique trading advantage in the handling of its FLEX Orders after transmitting its FLEX Orders to the applicable FLEX auction mechanism.

Rule 11a2-2(T)'s fourth condition requires that, in the case of a transaction effected for an account with respect to which the initiating member or an associated person thereof exercises investment discretion, neither the initiating member nor any associated person thereof may retain any compensation in connection with effecting the transaction, unless the person authorized to transact business for the account has expressly provided otherwise by written contract referring to Section 11(a) of the Act and Rule 11a2-2(T) thereunder.³³⁶ The Exchange

³³⁵ In considering the operation of automated execution systems operated by an exchange, the Commission noted that, while there is not an independent executing exchange member, the execution of an order is automatic once it has been transmitted into the system. Because the design of these systems ensures that members do not possess any special or unique trading advantages in handling their orders after transmitting them to the exchange, the Commission has stated that executions obtained through these systems satisfy the independent execution requirement of Rule 11a2-2(T). See 1979 Release.

³³⁶ See 17 CFR 240.11a2-2(T)(a)(2)(iv). In addition, Rule 11a2-2(T)(d) requires a member or associated person authorized by written contract to retain compensation, in connection with effecting transactions for covered accounts over which such member or associated persons thereof exercises investment discretion, to furnish at least annually to the person authorized to transact business for the account a statement setting forth the total amount of compensation retained by the member in connection with effecting transactions for the account during the period covered by the statement which amount must be exclusive of all amounts paid to others during that period for services rendered to effect such transactions. See also 1978 Release, at 11548 (stating "[t]he contractual and disclosure requirements are designed to assure that accounts electing to permit transaction-related compensation do so only after deciding that such arrangements are suitable to their interests").

³³¹ The member may, however, participate in clearing and settling the transaction.

³³² See, e.g., Securities Exchange Act Release Nos. 95445 (August 8, 2022), 87 FR 49894 (August 12, 2022) (SR-MEMX-2022-10) (approving options trading on MEMX Options); 61419 (January 26, 2010), 75 FR 5157 (February 1, 2010) (SR-BATS-2009-031) (approving BATS options trading); 59154 (December 23, 2008), 73 FR 80468 (December 31, 2008) (SR-BSE-2008-48) (approving equity securities listing and trading on BSE); 57478 (March 12, 2008), 73 FR 14521 (March 18, 2008) (SR-NASDAQ-2007-004 and SR-NASDAQ-2007-080) (approving NOM options trading); 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (File No. 10-131) (approving The Nasdaq Stock Market LLC); 44983 (October 25, 2001), 66 FR 55225 (November 1, 2001) (SR-PCX-00-25) (approving Archipelago Exchange); 29237 (May 24, 1991), 56 FR 24853 (May 31, 1991) (SR-NYSE-90-52 and SR-NYSE-90-53) (approving NYSE's Off-Hours Trading Facility); and 15533 (January 29, 1979), 44 FR 6084 (January 31, 1979) ("1979 Release").

³³³ The submitting Member may cancel a FLEX Auction prior to the end of the exposure interval. See proposed Options 3A, Section 11(b)(2)(C). Members may modify or cancel FLEX responses during the exposure interval. See Options 3A, Section 11(b)(2)(D)(v). An Initiating Member may not cancel or modify an Agency Order or Initiating Order after it has been submitted into FLEX PIM, except to improve the price of the Initiating Order. See proposed Options 3A, Section 12(c)(4). Members may modify or cancel their responses after being submitted to into a FLEX PIM. See proposed Options 3A, Section 12(c)(5)(F). An Initiating Member may not modify an Agency Order or Solicited Order after it has been submitted into FLEX SOM. See proposed Options 3A, Section 13(c)(4). Members may modify or cancel their responses after being submitted to into a FLEX SOM. See proposed Options 3A, Section 12(c)(5)(F). The Commission has stated that the nonparticipation requirement does not preclude members from cancelling or modifying orders, or from modifying instructions for executing orders, after they have been transmitted so long as the modifications or cancellations are also transmitted from off the floor. See Securities Exchange Act Release No. 14563 (March 14, 1978), 43 FR 11542, 11547 (the "1978 Release").

³³⁴ See *id.*

recognizes that Members relying on Rule 11a2–2(T) for transactions effected pursuant to the proposed FLEX rules, and in particular through the applicable FLEX auction mechanisms described above, must comply with this condition of the Rule and the Exchange will enforce this requirement pursuant to its obligations under Section 6(b)(1) of the Act to enforce compliance with federal securities laws.

The Exchange therefore believes that the proposed rules in Options 3A governing FLEX trading, including the proposed FLEX Auction, FLEX PIM, and FLEX SOM, are consistent with Rule 11a2–2(T).

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

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

The Exchange does not believe that the proposed rule change will impose any burden on intra-market competition that is not necessary or appropriate in furtherance of the purposes of the Act, as all Members who wish to trade FLEX Options will be able to trade such options in the same manner. Additionally, positions in FLEX Options of all Members will be subject to the same position limits, and such positions will be aggregated in the same manner as described in proposed Section 18(c).

The Exchange also does not believe that the proposed rule change will impose any burden on inter-market competition that is not necessary or appropriate in furtherance of the purposes of the Act. As discussed above, other options exchanges currently offer electronic FLEX trading and cash-settled FLEX ETF Options on their respective markets. The Exchange believes that its proposal will allow ISE to compete with these other exchanges and provide an additional execution venue for these transactions for market participants. Thus, the Exchange believes that its proposal will promote inter-market competition by increasing the number of exchanges where electronic FLEX trading and cash-settled FLEX ETF Options will be available. The proposal also promotes inter-market competition by providing another alternative (*i.e.*, exchange markets) to bilateral OTC trading of options with flexible terms. Exchange markets, in contrast with bilateral OTC trading, are centralized, transparent, and have the guarantee of OCC for options traded.

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. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to a national securities exchange.³³⁷ In particular, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(1) and 6(b)(5)³³⁸ of the Exchange Act. Section 6(b)(5) of the Exchange Act³³⁹ requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to foster cooperation and coordination with persons engaged in regulating, clearing, settling, and processing information with respect to, and facilitating transactions in securities; 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. Section 6(b)(5) also requires that the rules of a national securities exchange not be designed to permit unfair discrimination among customers, issuers, brokers, or dealers. Further, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(1) of the Exchange Act,³⁴⁰ which requires, among other things, that a national securities exchange be so organized and have the capacity to carry out the purposes of the Exchange Act, and to comply and enforce compliance by its members and persons associated with its members, with the provisions of the Exchange Act, the rules and regulations thereunder.

Specifically, the Exchange is proposing to list and trade FLEX Options³⁴¹ on the Exchange's electronic market. FLEX Options allow market

³³⁷ In approving the proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

³³⁸ 15 U.S.C. 78f(b)(1) and (5).

³³⁹ 15 U.S.C. 78f(b)(5).

³⁴⁰ 15 U.S.C. 78f(b)(1).

³⁴¹ *See* proposed Options 3A, Section 1(b) which defines a FLEX Option as a "flexible exchange option" and includes FLEX Options on an equity security (a "FLEX Equity Option") and on an index (a "FLEX Index Option"),

participants to customize certain specified terms (*i.e.*, expiration date, exercise price and exercise style) of equity and index options. The Exchange states that FLEX Options are currently traded on the Chicago Exchange, Inc. ("Cboe"), NYSE American LLC ("NYSE American"), NYSE Arca, Inc. ("NYSE Arca"), Nasdaq PHLX LLC ("Phlx"), and FLEX Equity Options are currently traded on BOX Exchange LLC ("BOX").³⁴² The Exchange further states that it believes its proposal will allow the Exchange to compete with these other exchanges and provide an additional execution venue in FLEX Options for market participants.³⁴³

The Exchange has proposed to allow for the trading of FLEX Options on its electronic market in a substantially similar manner as Cboe's electronic FLEX Options, with certain differences primarily intended to align its rules to current System³⁴⁴ and auction behavior in order to provide increased consistency for Members trading FLEX Options and non-FLEX Options on ISE.³⁴⁵ While the trading procedures applicable to FLEX Options will be similar to those for trading non-FLEX Options under the Exchange's electronic System, as discussed in more detail below, proposed Options 3A will specifically address the trading of FLEX Options including rules to address their customized nature as well as those non-FLEX options rules that are not applicable to FLEX Options.³⁴⁶ The Exchange's proposal is also consistent with the FLEX rules of other national securities exchanges that trade FLEX Options, and according to the Exchange are primarily based on, with certain exceptions, CBOE FLEX rules.³⁴⁷ The

³⁴² *See supra* note 23. All of the exchanges trade FLEX Options in open outcry on their respective trading floors, while Cboe also offers electronic FLEX Options trading.

³⁴³ *See* Amendment No. 1, at 145.

³⁴⁴ The term "System" means the electronic system operated by the Exchange that receives and disseminates quotes, executes orders and reports transactions. *See* Options 1, Section 1(a)(50).

³⁴⁵ For example, the Exchange states it is not proposing to add open outcry FLEX Options trading as it does not have a trading floor. *See* Notice, 89 FR 22295 n. 15.

³⁴⁶ For example, proposed Options 3A, Section 10 states that the Exchange simple and complex order books will not be available for FLEX Options.

³⁴⁷ In its proposal, ISE described the FLEX rules of Cboe upon which its proposed FLEX rules are based and, where there were differences, described those and the reasons for those differences. For example, the Exchange stated it primarily based its rules on Cboe but omitted certain rules that are floor based because it doesn't have a trading floor, such as Cboe Rule 5.75(b) which sets for the responsibilities of FLEX Officials, including the responsibility to nullify certain FLEX Option transactions that do not conform to Cboe's FLEX rules, and to call upon a FLEX Market-Maker with

Commission believes that the Exchange's proposal is designed to provide investors with a tailored or customized product for equity and index options that can be traded on the Exchange that may be more suitable to their investment needs. For the reasons described in more detail below, the Commission believes the proposal is consistent with the Exchange Act.

A. FLEX Equity and Index Options Requirements

1. General Provisions (Section 1)

FLEX Options traded on the Exchange will generally be subject to the same rules that apply to the trading of equity options and index options on the Exchange, unless otherwise provided in proposed Options 3A Rules.³⁴⁸ Among other things, proposed Options 3A Rules will provide the framework under which FLEX Options would be eligible for trading on the Exchange, including, but not limited to, the terms under which FLEX Options would be available (detailing the underlying security, type, exercise price and style, and expiration date), the form of settlement, fungibility provisions, minimum quoting and trading increments, exercise by exception requirements, position and exercise limits, trading halts and letters of guarantee. In addition, there will be no simple or complex order books available for FLEX Options which is consistent with the rules of other national securities exchanges that trade FLEX Options.³⁴⁹ FLEX Options, as discussed in more detail below, will be traded by orders being inputted into the Exchange's electronic FLEX Auction, FLEX Price Improvement Auction (FLEX PIM), or FLEX Solicited Order Mechanism ("SOM"). As the Exchange states these auction functionalities are similar to the Systems for executing non-FLEX options with differences to accommodate the customized nature of FLEX Options and that there is no order book available or continuous quotes in FLEX Options. As stated by the

an appointment in a FLEX Option class to respond to open outcry FLEX Auctions in that FLEX Option class when no other ICMF's respond. *See, e.g.*, Amendment No. 1, at note 18. *See also* Amendment No. 1, at pages 146–153 for a list of the similar rules and differences between Cboe rules and new Exchange Rule Options 3A.

³⁴⁸ *See* proposed Options 3A, Section 1(a) that sets forth the applicability of Exchange Rules and provides that Options 3A Rules apply only to FLEX Options and that trading of FLEX Options will be subject to all other Rules applicable to the trading of options on the Exchange, unless otherwise provided in Options 3A.

³⁴⁹ *See supra* note 83. Because of the customized nature of FLEX Options and that there are no pre-established outstanding series in FLEX Options such options are not continuously quoted and there is no national best bid and offer in FLEX Options.

Exchange FLEX Options in its electronic market will trade in a substantially similar manner to Cboe's electronic FLEX Options. Further, the Exchange has represented that it has conducted a thorough review of its existing trading rules to ensure that the proposed Rules in Options 3A accurately reflect the application of the Exchange's non-FLEX Option trading rules to FLEX Options, as well as those non-FLEX Options trading rules that would not apply to FLEX Options. The ISE proposal, as stated above, is also consistent with the FLEX rules of other national securities exchanges that trade FLEX Options.³⁵⁰

2. FLEX Option Classes, Permissible Series and Fungibility (Section 3)

Proposed Section 3(a) allows the Exchange to authorize for trading a FLEX Option class on any equity security, with the exception of the iShares Bitcoin Trust ETF ("IBIT"), or index if it may authorize for trading a non-FLEX Option class on that equity security or index, even if the Exchange does not list that non-FLEX Option class for trading.³⁵¹ The Exchange proposes to exclude IBIT from being eligible for trading as a FLEX Option on ISE to be consistent with the Commission's approval of IBIT options, which required the position limit for IBIT options to be 25,000 contracts.³⁵² As discussed in the position limits section below, there will generally be no position limits for FLEX Equity Options.³⁵³ For clarity, this exclusion will apply to both physically-settled and cash-settled FLEX ETF options, such that IBIT options will be excluded from being eligible to trade as a physically-settled or a cash-settled FLEX ETF option. If the Exchange determines to allow FLEX trading on IBIT options at a later date, it will do so by submitting a 19b-4 rule filing with the Commission.

FLEX Options will only be permitted in puts and calls that do not have the same exercise style (American or European), same expiration date and same exercise price as Non-FLEX Options that are already available for trading on the same underlying security, provided the option is otherwise eligible for trading. The Exchange states that its System enforces these requirements and

³⁵⁰ *See supra* note 347.

³⁵¹ Proposed Section 3(b) would allow the Exchange to approve a FLEX Option series for trading in any FLEX Option class it may authorize for trading pursuant to proposed Section 3(a).

³⁵² *See* Securities Exchange Act Release No. 101128 (September 20, 2024), 89 FR 78942 (September 26, 2024) (SR-ISE-2024-03). *See also* Amendment No. 1, at 14.

³⁵³ *See* proposed Options 3A, Section 18(b)(1)(A).

that its System will not accept a FLEX Order for a put or call FLEX Option series if a non-FLEX Option series on the same underlying security or index with the same expiration date, exercise price, and exercise style is already listed for trading. Under the proposal a FLEX Order for a FLEX Option may be submitted on any trading day prior to the expiration date although on the expiration date, a FLEX Order for the expiring FLEX Option series may only be submitted to close out a position in such expiring FLEX Option series.³⁵⁴

FLEX Options can also be listed before an option with identical terms is listed for trading as a non-FLEX Option. Proposed Section 3(d)(1) provides that if the Exchange lists for trading a non-FLEX Option series with identical terms as a FLEX Option series, (A) all existing open positions established under the FLEX trading procedures will become fully fungible with transactions in the identical non-FLEX Option series and (B) any further trading in the series would be as non-FLEX Options subject to non-FLEX trading procedures and rules. If a non-FLEX Option Series is added intraday, for the balance of that trading day, a position established under the FLEX trading procedures may be closed using the FLEX trading procedures only against another closing only FLEX position.³⁵⁵ The Exchange will notify Members when a FLEX Option series is restricted to closing only transactions and the System will reject a transaction in such a restricted series that does not conform to the requirements specified in proposed Section 3(d).

As the Commission has previously stated, it has been concerned about FLEX Options acting as a surrogate for trading in standardized non-FLEX Options given the protections for investors in the non-FLEX Options market, and the fungibility provisions could help to mitigate some of these concerns.³⁵⁶ The Commission continues to believe that requiring FLEX Options

³⁵⁴ *See* Proposed Options 3A Section 3(b)(2). The Exchange represented that the Exchange's System will enforce this provision such that it will reject an opening position in an expiring FLEX Option series on the day of expiration. *See* Amendment No. 1, at 15, note 3. *See also* Proposed Options 3A Section 3(d) when expiration falls on a holiday.

³⁵⁵ This is because in the event a Non-FLEX Equity Option with identical terms to a FLEX Equity Option is listed intraday, OCC could not net the positions in the contracts until the next day potentially leading to assignment risk. *See* Securities Exchange Act Release No. 62321 (June 17, 2010), 75 FR at 36131 (June 24, 2010).

³⁵⁶ *See* Securities Exchange Act Release No. 59417 (February 18, 2009), 74 FR 8591 (February 25, 2009) (Order providing for fungibility of FLEX and non-FLEX option series with same terms upon listing of non-FLEX option series).

to be fungible with their non-FLEX counterparts could help to address the surrogacy concerns and ensure that market participants can avail themselves of the protections provided in the standardized market.

The proposed rule text should provide greater transparency around the Exchange's listing standards and ensure that the listing and trading of FLEX Options is consistent with ISE's approval order of IBIT options.

3. FLEX Options Terms (Section 3(c))

Proposed Section 3(c) specifies the terms that must be included in a FLEX Order. Such terms include: (1) the underlying equity security or index; (2) the type of option (*i.e.*, put or call); (3) the exercise style (American or European); (4) the expiration date with terms no longer than 15 years;³⁵⁷ (5) the settlement type; and (6) the exercise price, in increments no smaller than \$0.01. The Exchange may determine the smallest increment for exercise prices of FLEX Options on a class-by-class basis, without going lower than \$0.01.

The Exchange has noted that the terms applicable to FLEX Options are consistent with rules previously approved by the Commission for other exchanges in that they will permit investors to customize some of the terms of their FLEX Options to implement more precise trading strategies.

Under the proposal, settlement for index options can be either a.m. (settlement value determined by reported opening prices of component securities) or p.m. (settlement value determined by reported closing prices of component securities). The Exchange has proposed to permit p.m. settlement in FLEX Index Options, including on the third Friday of the month (known as "Expiration Fridays") similar to that approved for another national securities exchange. In the context of approving CBOE's Flex PM Pilot on a permanent basis the Commission stated that the CBOE's pilot data and reports, demonstrated that its pm pilot has benefited investors and other market participants by providing more flexible trading and hedging opportunities while also having shown no evidence of an adverse impact on the market. The Commission further stated, among other things, that the market for FLEX PM Third Friday Options had remained relatively small compared to non-FLEX p.m.-settled index options and the studies and analysis of the pilot data did

³⁵⁷ The expiration date may be any business day (specified to the day, month, and year) no more than 15 years from the date on which a member submits a FLEX Order to the system. See proposed Options 3A, Section 3(c)(4).

not identify any adverse market impact on the underlying indexes, components of those indexes or related products or any significant impact on market quality of a.m.-settled index options.³⁵⁸ The Commission has made similar conclusions in approving rules on p.m. settlement for non-FLEX Options including on the P.M.-settled Nasdaq-100 Index ("NDX") Options with a Third-Friday-of-the-Month expiration.³⁵⁹ Further, significant changes in closing procedures in the decades since index options moved to a.m. settlement may also serve to mitigate the potential impact of p.m.-settled index options on the underlying cash markets.

4. Types of Orders; Order and Quote Protocols (Sections 6 and 7)

Proposed Section 6(a) provides that the Exchange may determine to make only the Limit Order and Cancel and Replace Order order types available on a class or System basis for FLEX Orders. The Exchange may also determine to make only the Immediate-or-Cancel time-in-force available on a class or System basis for FLEX Orders. Proposed Section 6(b) provides that the only order and quote protocols that will be available for FLEX Orders, FLEX auction notifications, and FLEX auction responses are: FIX ("Financial Information eXchange"); OTTO ("Ouch to Trade Options"); and SQF ("Specialized Quote Feed").

³⁵⁸ *Id.* As noted above, for Third-Friday expirations ISE currently only has authority to trade non-FLEX on the NDX and therefore would only be allowed to trade P.M.-settled Third-Friday-of-the-Month index options on the NDX. See Securities Exchange Act Release No. 98935 (November 14, 2023), 88 FR 80792 (November 20, 2023) (SR-ISE-2023-20).

³⁵⁹ See Securities Exchange Act Release Nos. 99222 (December 21, 2023) (SR-CBOE-2023-018) (order making permanent the operation of Cboe's FLEX Options pilot program regarding permissible exercise settlement values for FLEX Index Options); 98454 (September 20, 2023) (SR-CBOE-2023-005) (order approving proposed rule change to make permanent the operation of a program that allows the Exchange to list p.m.-settled third Friday-of-the-month SPX options series) ("SPXPM Approval"); 98455 (September 20, 2023) (SR-CBOE-2023-019) (order approving proposed rule change to make permanent the operation of a program that allows the Exchange to list p.m.-settled third Friday-of-the-month XSP and MRUT options series) ("XSP and MRUT Approval"); and 98456 (September 20, 2023) (SR-CBOE-2023-020) (order approving proposed rule change to make the nonstandard expirations pilot program permanent) ("Nonstandard Approval"). See also Securities Exchange Act Release Nos. 98450 (September 20, 2023), 88 FR 66111 (September 26, 2023) (SR-ISE-2023-08) (order approving proposed rule change to make permanent certain p.m.-settled pilots); and 98935 (November 14, 2023), 88 FR 80792 (November 20, 2023) (SR-ISE-2023-20) (order approving a proposed rule change to permit the listing and trading of p.m.-settled Nasdaq-100 IndexSM Options with a third-Friday-of-the-month expiration).

Proposed Section 6 could aid in FLEX Order executions and should provide greater transparency as to which order and quote protocols will be available for FLEX Orders, FLEX auction notifications, and FLEX auction responses.

Proposed Section 7(a) covers the operation of complex orders, include a Complex Options Order, Stock-Options Order, and Stock-Complex Order. Each leg of a complex FLEX Order: (1) must be for a FLEX Option series authorized for FLEX trading with the same underlying equity security or index; (2) must have the same exercise style; and (3) for a FLEX Index Option, may have a different settlement type (a.m.-settled or p.m.-settled). Also, each options leg of a complex order cannot go below the \$0.01 minimum increment.

Proposed Section 7 will provide investors with additional transparency regarding order entry of complex FLEX Options and will remove impediments to and perfect the mechanism of a free and open market, benefiting investors.

5. Opening of FLEX Trading and Trading Halts (Sections 8 and 9)

Proposed Section 8(a) provides that there will be no Opening Process. Members may begin submitting FLEX Orders into an electronic FLEX Auction pursuant to proposed Section 11(b), a FLEX PIM pursuant to proposed Section 12, or a FLEX SOM pursuant to proposed Section 13 when the underlying security is open for trading. Proposed Options 3A, Section 8(a) and (b) are based on Cboe Rule 5.71, except with respect to open outcry trading and trading sessions outside of regular trading hours.³⁶⁰ The Exchange stated its belief that because market participants incorporate transaction prices of underlying securities or the value of underlying indexes when pricing options (including FLEX Options), the Exchange believes that it will benefit investors for FLEX Options trading to not be available until that information has begun to be disseminated in the market.

In addition, proposed Section 9 provides that the Exchange may halt trading in a FLEX Option and will always halt trading in a FLEX Options class when trading in a non-FLEX Options class with the same underlying equity security or index is halted on the Exchange.

Proposed Section 9 adds clarity and transparency as to when FLEX Orders can be submitted since there is no opening process, as in the non-FLEX

³⁶⁰ See Amendment No. 1, at note 75.

Options market, and when the Exchange would halt trading in FLEX Options.

6. FLEX Options Auction Trading (Sections 11, 12 and 13)

Proposed Section 11 details the procedures for FLEX trading on the Exchange. A FLEX Options series will only be eligible for trading if a Member submits a FLEX Order for that series into an electronic FLEX Auction pursuant to paragraph (b) of Options 11, or submits the FLEX Order to a FLEX PIM or FLEX SOM Auction pursuant to proposed Section 12 or proposed Section 13, respectively. Proposed Section 11(a) specifies the requirements for simple and complex FLEX Orders while proposed Section 11(b) describes how the electronic FLEX Auction will work.

The Exchange has represented that it will System enforce the stipulation that it will not accept simple or complex FLEX Orders if the FLEX Order or any leg of a complex FLEX Order, as applicable, has identical terms as a non-FLEX Option series that is already listed for trading. The proposed FLEX Auction will offer market participants with an auction mechanism that offers potentially improved prices. The initiating Member must designate the length of the exposure interval for the order which must be between three seconds and five minutes, which is the same exposure time frame under Cboe' electronic auction rules. Each auction will remain open for the designated time between three seconds and five minutes and if the designated time exceeds the market close, the auction will end at the market close with an execution, if permitted.³⁶¹ The proposed FLEX Auction will promote executions in electronic FLEX Auctions while also preventing executions after the market close. In addition, the Exchange will not allow Members to submit multiple FLEX responses using the same badge/mnemonic and will not aggregate all responses at the same price. Proposed Section 11(b)(2)(D) specifies that an additional FLEX response from the same badge/mnemonic for the same auction ID will automatically replace the previous FLEX response.

The Exchange believes that having these features harmonized with the Exchange's current auction functionality for non-FLEX Orders will promote consistency for Members participating across different auctions on ISE. Importantly, the Exchange has stated that its System will prohibit a FLEX Order from being accepted if it has the same terms (*i.e.*, expiration date,

exercise price, and exercise style) of a non-FLEX Option.

Use of the electronic FLEX Auction, that is similar in function to existing functionality with differences to accommodate FLEX and the accompanying clarity this will provide to Members and market participants, should be beneficial to market participants and should be beneficial to market participants.

Proposed Section 12 establishes the FLEX price improvement mechanism ("PIM"). The FLEX PIM is a price improvement mechanism auction that allows Members to provide price improvement opportunities for transactions. A Member may electronically submit for execution an order it represents as agent against principal interest or a solicited order(s), provided it submits the Agency Order for electronic execution into a FLEX PIM auction. The proposed FLEX PIM is substantially similar to Cboe's FLEX AIM except that the FLEX PIM will not allow prices to be entered as a percentage value. Proposed Section 13 establishes the FLEX solicited order mechanism ("SOM") auction functionality for FLEX Options. The FLEX SOM is an auction that allows Members to submit complex orders for a single-price all-or-none execution. A Member may electronically submit for execution an order it represents as agent against a solicited order if it submits the Agency Order for electronic execution into a FLEX SOM auction.

As with the FLEX Auction, the initiating Member must designate the length of the exposure interval for the order which must be between three seconds and five minutes. Both the FLEX PIM and FLEX SOM auctions will remain open for the designated time between three seconds and five minutes and if the designated time exceeds the market close, the auction will end at the market close with an execution, if permitted.³⁶² The Exchange's FLEX PIM and FLEX SOM, unlike Cboe's FLEX PIM and FLEX SAM, respectively, specifies that if the designated length of the FLEX PIM or SOM auction period exceeds the market close, then the auction will end at the market close with an execution, if an execution is permitted.

The FLEX Auctions, FLEX PIM and FLEX SOM rules also provide provisions on order execution priority and allocations. Generally, FLEX Auctions, FLEX PIM and FLEX SOM will apply the same priorities as it applies under its current rules for non-FLEX options. The System will execute

trading interest at the best price with Priority Customers³⁶³ having priority over non-Priority Customers at the same price with time priority (*i.e.*, meaning that priority shall be afforded to Priority Customer orders in the sequence received by the System). Allocations generally follow the exiting rules for the exchange non-FLEX auctions but the Exchange is aligning its rule with CBOE's rules instead of providing the standard 40% for standard PIM.³⁶⁴ The clarity in how FLEX PIM and FLEX SOM Auctions will function, as well as the explanations for the differences between the FLEX PIM and SOM and Cboe's FLEX AIM and SAM, should be beneficial to market participants.

7. Risk Protections (Section 14)

Proposed Section 14 specifies which of the Exchange's risk protections apply to FLEX trading. Specifically, the Market Wide Risk Protection and Size Limitation will be available to FLEX Options. Market Wide Risk Protections are mandatory activity-based protections that allow Members to establish limits for order entry and execution rate during a specified period of time. The Size Limitation is a limit on the number of contracts an incoming order may specify. Orders that exceed the maximum number of contracts are rejected. This maximum is established by the Exchange from time-to-time.

Proposed Section 14(b) provides that the following complex order risk protections are available to FLEX Options: Strategy Protections (only to FLEX Auctions and FLEX responses in proposed Section 11(b)), Size Limitation, the Price Limit for Complex Order protection as applicable to the stock component, the Stock-Tied NBBO protections, and the Stock-Tied Reg SHO protections. The Exchange notes that the risk protections specified in proposed Sections 14(a) and 14(b) are mandatory.

Proposed Section 14(c) provides that the following optional risk protections (from Options 3, Section 28) are available: (1) notional dollar value per order; (2) daily aggregate notional dollar value; (3) quantity per order; and (4) daily aggregate quantity.

Applying these risk protections to FLEX Options will protect investors and the public interest, and may help with maintaining fair and orderly markets, by providing market participants with more tool with which to manage their risk.

³⁶³ See Amendment No. 1, at 50–54.

³⁶⁴ See Amendment No. 1, at note 150.

³⁶¹ See proposed Options 3A, Section 11(b)(1)(F).

³⁶² See proposed Options 3A, Section 12(c)(3).

8. FLEX Market Makers and Letters of Guarantee (Sections 16 and 17)

Proposed Section 16 governs FLEX Market Makers. Proposed Section 16(a) provides that a FLEX Market Maker will automatically receive an appointment in the same FLEX option class(es) as its non-FLEX class appointments, but only the Primary Market Maker in the non-FLEX Option may be assigned Primary Market Maker in that FLEX Option. Proposed Section 16(b) provides that FLEX Market Makers do not need to provide continuous quotes in FLEX Options, but a FLEX Market Maker must fulfill all of the obligations of a Market Maker under Options 2 and must comply with the applicable provisions.

Proposed Section 17(a) provides that no FLEX Market Maker shall effect any transactions in FLEX Options unless one or more effective Letter(s) of Guarantee has been issued by a Clearing Member and filed with the Exchange accepting financial responsibility for all FLEX transactions made by the FLEX Market Maker pursuant to Options 6, Section 4. The Letters of Guarantee for FLEX transactions of FLEX market makers should, as the Exchange states, help to protect investors and the public interest because they signify that the clearing member has accepted financial responsibility for such FLEX transactions thus protecting the counterparties to those trades.³⁶⁵

The provisions contained in proposed Sections 16 and 17 will provide additional clarity and transparency as to how FLEX Market Makers are appointed and their responsibilities and will ensure that the appropriate guarantees are available to market participants for FLEX transactions.

9. Position Limits and Exercise Limits (Sections 18 and 19)

Proposed Section 18 details the position limits for FLEX Options. Specifically, proposed Section 18(a) governs the position limits for FLEX Index Options and provides that FLEX Index Options will be subject to the same position limits governing non-FLEX index options in Options 4A, Sections 6 and 7. However, except as provided in Options 4A, Section 6(a) as set forth below, in no event shall the positions limits for broad-based FLEX Index Options exceed 25,000 contracts on the same side of the market. In addition, there shall be no position limits for those broad-based index options listed in Options 4A, Section 6(a).³⁶⁶

Each Member (other than FLEX Market Makers) that maintains a FLEX broad-based index position on the same side of the market in excess of 100,000 contracts in NDX or RUT for its own account, or for the account of a customer, shall report information as to whether the positions are hedged and provide documentation as to how such contracts are hedged, in the manner and form required by the Exchange. In addition, industry-based FLEX Index Options shall be subject to separate position limits of 18,000, 24,000, or 31,500 contracts, depending on the position limit tier determined pursuant to Options 4A, Section 7(a)(1).³⁶⁷

Proposed Section 18(b) governs the position limits for FLEX Equity Options. Proposed Section 18(b)(1)(A) provides that there will generally be no position limits for FLEX Equity Options except for FLEX cash-settled ETFs, as discussed in detail below.³⁶⁸ Each Member (other than a Market Maker) that maintains a position on the same side of the market in excess of the standard limit under Options 9, Section 13 for non-FLEX Equity Options of the same class on behalf of its own account or for the account of a customer shall report information on the FLEX Equity option position, positions in any related instrument, the purpose or strategy for the position and the collateral used by the account, in the form and manner prescribed by the Exchange. Whenever the Exchange determines that a higher margin requirement is necessary in light of the risks associated with a FLEX Equity Options position in excess of the standard position limit for Non-FLEX Equity Options of the same class, the Exchange may consider imposing additional margin upon the account maintaining such under-hedged position.³⁶⁹

Proposed Section 18(c) governs the aggregation of FLEX positions and states that for purposes of the position limits and reporting requirements, FLEX Option positions shall not be aggregated with positions in non-FLEX Options except in certain situations provided for in proposed Section 18(c) and in proposed Section 18(b)(1)(B) (setting forth position limits for cash-settled

Nasdaq 100 Index, Mini Nasdaq 100 Index; Nations VolDex Index, Nasdaq 100 Reduced Value Index; and Nasdaq Micro Index Options.

³⁶⁷ See proposed Options 3A, Section 18(a)(4). The Commission notes that these position limits are identical to those in place for Cboe. See Cboe Rules 8.32 and 8.35.

³⁶⁸ See Amendment No. 1, at 76–77 and Proposed 3A, Section 18(b)(1)(B).

³⁶⁹ The clearing firm carrying the account will be subject to capital charges under SEC Rule 15c3–1 to the extent of any margin deficiency resulting from a higher margin requirement.

FLEX ETF options discussed below. Proposed Section 18(c)(1) states that commencing at the close of trading two business days prior to the last trading day of the calendar quarter, positions in P.M.-settled FLEX Index Options shall be aggregated with position in Quarterly Options Series on the same index with the same expiration and shall be subject to the position limits set forth in Options 4A, Section 6 or Section 7, as applicable. In addition, proposed Section 18(c)(2) states that commencing at the close of trading two business day prior to the last trading day of the week, positions in FLEX Index Options that are cash settled shall be aggregated with positions in Short Term Option Series on the same underlying with the same means for determining exercise settlement value and same expiration, and shall be subject to the position limits set forth in Options 4A, Section 6 or Section 7, as applicable. Finally, proposed Section 18(c)(3) states that for as long as the options positions remain open, positions in FLEX Options that expire on the third Friday-of-the-month shall be aggregated with positions in non-FLEX Options on the same underlying security and shall be subject to the position limits set forth in Options 4A, Section 6 or Section 7, or Options 9, Section 13, as applicable, and the exercise limits set forth in Options 9, Section 15.

Proposed Section 19(a) provides that exercise limits for FLEX Options shall be equivalent to the FLEX position limits prescribed in proposed Section 18.³⁷⁰ In addition, there shall be no exercise limits for those broad-based index options listed in Options 4A, Section 6(a).³⁷¹

The enhanced reporting requirements and margin provisions as well as the requirement that FLEX Options that expire on an Expiration Friday be subject to, and aggregated with, standard non-FLEX Options position and exercise limits are the same position and exercise limit requirements that apply under the rules of the other exchanges that currently trade FLEX Options. It is therefore appropriate for ISE to have the same position and exercise limit rules for FLEX Options as these other exchange markets. As the Commission has previously stated,

³⁷⁰ Proposed Options 3A, Section 19(a)(1) indicates that the minimum value size for FLEX Equity Option exercises shall be 25 contracts or the remaining size of the position, whichever is less. Proposed Options 3A, Section 19(a)(2) indicates that the minimum value size for FLEX Index Option exercises shall be \$1 million in Underlying Equivalent Value (as defined in Section 19) or the remaining Underlying Value of the position, whichever is less.

³⁷¹ See Amendment No. 1, at 80.

³⁶⁵ See Amendment No. 1, at 129.

³⁶⁶ The broad-based index options listing in Options 4A, Section 6(a) currently are options on

while it cannot entirely rule out the potential for future adverse effects on the securities markets for the FLEX Options or component securities underlying FLEX Options, the continued enhanced market surveillance of positions should help the Exchange to take the appropriate action in order to avoid any manipulation or market risk concerns.³⁷² The Commission expects ISE, as it has the other exchanges trading FLEX Options, to take prompt action including timely communication with the Commission and other marketplace self-regulatory organizations responsible for oversight of trading in FLEX Options and the underlying stocks, should any unanticipated adverse market effects develop.

10. Summary

The Commission notes that the listing and trading rules are modeled on FLEX rules previously approved by the Commission. Furthermore, the Commission believes that the Exchanges rules governing its hours of business, minimum increments, the trading auctions, position and exercise limits, letters of guarantee, and trading halts, among other things, are consistent with the Exchange Act, and Section 6(b)(5)³⁷³ therein. Finally, the Commission notes that the proposed rules are substantially similar to those already approved for other Exchanges, in particular, those of Cboe.³⁷⁴

B. Cash-Settled FLEX ETFs

The Commission also believes, for the reasons discussed below, that the portion of the proposed rules to trade cash settled FLEX ETFs that meet certain specified criteria are consistent with the requirements of Section 6(b)(5) of the Act,³⁷⁵ which requires, among other things, that the rules of a national securities exchange be designed to

prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

The Exchange's proposal would allow cash settlement for FLEX Equity Options only on ETFs, and only where the underlying ETF, as measured over the prior six-month period, has (1) an average daily notional value of at least \$500 Million; and (2) a national ADV of at least 4,680,000 shares.³⁷⁶ The Commission notes, and the Exchange has represented, that the 46 ETFs³⁷⁷ currently eligible using the proposed criteria appear to be among some of the most liquid and actively-traded ETFs based on their average daily volume and average notional value. The Commission believes that, by limiting the trading of options permitted to have cash settlement to those with underlying ETFs and only where these ETFs are liquid and actively traded, along with the other proposed requirements, appears to be reasonably designed to mitigate concerns about the susceptibility to manipulation of such cash-settled FLEX ETF Options and their underlying ETFs and the potential for market disruption. Additionally, the proposed aggregated position and exercise limits and surveillance procedures discussed below, taken together with the liquid and active markets in the underlying eligible ETFs, also appears reasonably designed to address and mitigate concerns about the potential for manipulation and market disruption in markets for the options and the underlying securities.

The Commission also notes that the Exchange has proposed to use the same position limits and exercise limits for cash-settled FLEX ETF Options that are applicable to the non-FLEX standardized options market, and to aggregate the positions in cash-settled FLEX ETF Options with all positions on physically-settled options on the same underlying ETF for purposes of calculating the position and exercise

limits.³⁷⁸ This is structured the same as on other exchanges that currently trade cash-settled FLEX ETFs under the same criteria described above. The Commission has previously recognized that position and exercise limits serve as a regulatory tool designed to address manipulative schemes and adverse market impact surrounding the use of options and that the limits can be useful to prevent investors from disrupting the market in securities underlying the options as well as the options market itself.³⁷⁹ The Commission believes therefore that establishing position and exercise limits at the same levels as those in the non-FLEX standardized options market and aggregating those positions with all physically-settled options on the same underlying ETFs³⁸⁰ can further help mitigate the concerns that the limits are designed to address about the potential for manipulation and market disruption in the options and the underlying securities.

The Commission notes that the Exchange will conduct a biannual review of the underlying ETFs to determine whether they no longer meet the requirements for cash-settled FLEX ETF Options on those ETFs.³⁸¹ The Commission believes that this requirement is a reasonable means to limit cash settlement to those FLEX ETF Options that only overlie ETFs that continue to meet the specified liquidity and trading volume standards. The Commission also believes that while, as part of the biannual review, the Exchange can identify new underlying ETFs that meet the requirements and are thus eligible for cash-settled FLEX ETF Options, limiting the number of qualifying underlying ETFs to 50 will prevent the scope of cash settlement on FLEX ETF Options from growing considerably without an evaluation about whether the level of the requirements remains reasonable.³⁸² The Commission further believes that selecting the top 50 securities based on ETFs with the highest ADV, if more than 50 ETFs otherwise meet the

³⁷² The Commission, for example stated, in approving FLEX Equity Options with no position limits, that the monitoring of accounts should provide the Exchanges with information necessary to determine whether to impose additional margin and/or assess capital charges and also determine whether a large position could have an undue effect on the underlying market and to take the appropriate action. See Securities Exchange Act Release No. 42223 (December 10, 1999), 64 FR 71158 (December 20, 1999) (Order approving the elimination of position and exercise limits for FLEX Equity Options). See also Securities Exchange Act Release No. 42346 (January 18, 2000), 65 FR 4010 (January 25, 2000) (Order approving the elimination of position and exercise limits for FLEX Equity Options).

³⁷³ *Id.*

³⁷⁴ See Securities Exchange Act Release No. 99222 (December 21, 2023), 88 FR 89771 (December 28, 2023) (SR-CBOE-2023-018).

³⁷⁵ 15 U.S.C. 78f(b)(5).

³⁷⁶ See Amendment No. 1, at 82–83. These are the same requirements that both Cboe and NYSE American have to trade FLEX-cash settled ETFs. See Securities Exchange Act Release No. 98044 (August 2, 2023), 88 FR 53548 (August 8, 2023) (SR-Cboe-2023-036) (Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Allow Certain Flexible Exchange Equity Options To Be Cash Settled) and Securities Exchange Act Release No. 88131 (February 5, 2020), 85 FR 7806 (February 11, 2020) (SR-NYSEAm-2019-38) (Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, To Allow Certain Flexible Equity Options To Be Cash Settled).

³⁷⁷ See Amendment No. 1, at 14 and 87.

³⁷⁸ See Amendment No. 1, at note 248 and accompanying text.

³⁷⁹ See Securities Exchange Act Release No. 82770 (February 23, 2018), 83 FR 8907, 8910 (March 1, 2018) (SR-CBOE-2017-057).

³⁸⁰ The aggregation of position and exercise limits would include all positions on physically-settled FLEX and non-FLEX options on the same underlying ETFs.

³⁸¹ See Amendment No. 1, at note 237 and accompanying text.

³⁸² See Amendment No. 1, at 84. At the same time, the overall limit of 50 ETFs that can underlie cash settled FLEX ETF Options should also provide the Exchange with flexibility to add additional ETFs that meet the Exchange's requirements given that the current eligible list of ETFs as of June 30, 2024 contains 46 ETFs.

requirements in Section 3(c), appears to be a reasonable tiebreaker. In addition, the Commission notes that, should the Exchange determine, pursuant to the bi-annual review that an underlying ETF ceases to satisfy the requirements under Section 3(c), any new options position overlying such ETF would be required to have exercise settlement by physical delivery and any open cash-settled FLEX ETF Option positions may be traded only to close the position.³⁸³ The Commission believes that this provision is a reasonable means to address how to wind down an outstanding cash-settled FLEX ETF Option where the underlying ETF no longer qualifies under the liquidity and volume criteria, thereby addressing manipulation concerns, while still allowing market participants to close out positions.

While two exchanges commenced trading FLEX cash settled ETFs in August, 2023 under similar rules as those proposed by ISE, the proposal is significant in that the large majority of exchange traded equity options are still physically settled and the proposal would allow options on ETFs that currently are only available to be traded on ISE with physical settlement to now have a cash-settlement alternative as a FLEX Option on the specified ETFs. The Exchange, acknowledging the “novel characteristics” of its proposal has committed to perform periodic data analyses with written assessments and to make such analyses and assessments available to the Commission on an annual basis for the first five years of trading in the subject options.³⁸⁴ As noted above, the Exchange has also stated that the reports will discuss any recommendations it has on enhancements to its proposed listing standards based on these reviews. The Commission notes that the annual reports will allow the Commission and the Exchange to evaluate, among other things, the impact such options have, and any potential adverse effects, on price volatility and the market for the underlying ETFs, the component securities underlying the ETFs, and the options on the same underlying ETFs and make appropriate recommendations, if any, in response to the reports.

The Commission notes that surveillance is important, among other things, to detect and deter fraudulent and manipulative trading activity as well as other violations of Exchange

rules and the federal securities laws. The Exchange has represented that it has adequate surveillance procedures in place to monitor trading in these options and the underlying securities, including to detect manipulative trading activity in both the options and the underlying ETF and to identify unusual and/or illegal trading activity.³⁸⁵ The Commission notes that the proposed surveillance, along with the liquidity criteria and position and exercise limits requirements, appear to be reasonably designed to mitigate manipulation concerns. The Exchange has represented that it will periodically review its surveillance procedures and make any enhancements and/or modifications that might be needed for cash settlement of FLEX ETF Options.

The Commission notes that cash-settled FLEX ETF Options will be subject to the same trading rules and procedures that will govern the trading of FLEX Options on the Exchange, with the exception of the rules to accommodate the cash settlement feature being approved herein. The Commission also notes that the Exchange has represented that it will monitor any effect additional options series listed under the proposal have on market fragmentation and the capacity of the Exchange’s automated systems.³⁸⁶ Finally, the Commission expects that the Exchange will take prompt action, including timely communication with the Commission and with other self-regulatory organizations responsible for oversight of trading in options, the underlying ETFs, and the ETFs’ component securities, should any unanticipated adverse market effects develop.

Based on the Exchange’s representations with respect to the proposed cash-settlement of FLEX Equity Options, whose underlying security is an ETF, and that the proposed rules are substantially similar to other exchanges trading similar FLEX Options as well as the on-going reporting requirement, the Commission believes this part of the Exchange’s proposal is consistent with the Act.

C. Section 11(a) of the Exchange Act

Section 11(a)(1) of the Act³⁸⁷ prohibits a member of a national securities exchange from effecting transactions on that exchange for its own account, the account of an associated person, or an account over which it or its associated person exercises investment discretion (collectively, “covered accounts”) unless an exception applies. Rule 11a2–2(T) under the Act,³⁸⁸ known as the “effect versus execute” rule, provides exchange members with an exemption from the Section 11(a)(1) prohibition. Rule 11a2–2(T) permits an exchange member, subject to certain conditions, to effect transactions for covered accounts by arranging for an unaffiliated member to execute transactions on the exchange. To comply with Rule 11a2–2(T)’s conditions, a member: (i) must transmit the order from off the exchange floor; (ii) may not participate in the execution of the transaction once it has been transmitted to the member performing the execution;³⁸⁹ (iii) may not be affiliated with the executing member; and (iv) with respect to an account over which the member or an associated person has investment discretion, neither the member nor its associated person may retain any compensation in connection with effecting the transaction except as provided in the Rule. For the reasons set forth below, the Commission believes that Members entering orders and responses into the electronic FLEX Auction, FLEX PIM and FLEX SOM could satisfy the requirements of Rule 11a2–2(T).

The Rule’s first condition is that orders for covered accounts be transmitted from off the exchange floor. In the context of automated trading systems, the Commission has found that the off-floor transmission requirement is met if a covered account order is transmitted from a remote location directly to an exchange’s floor by electronic means.³⁹⁰ ISE represents that

³⁸⁷ 15 U.S.C. 78k(a)(1).

³⁸⁸ 17 CFR 240.11a2–2(T).

³⁸⁹ This prohibition also applies to associated persons. The member may, however, participate in clearing and settling the transaction.

³⁹⁰ See, e.g., Securities Exchange Act Release Nos. 61419 (January 26, 2010), 75 FR 5157 (February 1, 2010) (SR–BATS–2009–031) (approving BATS options trading); 59154 (December 23, 2008), 73 FR 80468 (December 31, 2008) (SR–BSE–2008–48) (approving equity securities listing and trading on BSE); 57478 (March 12, 2008), 73 FR 14521 (March 18, 2008) (SR–NASDAQ–2007–004 and SR–NASDAQ–2007–080) (approving NOM options trading); 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (File No. 10–131) (approving The Nasdaq Stock Market LLC); 44983 (October 25,

Continued

³⁸³ See Amendment No. 1, at 84.

³⁸⁴ See Amendment No. 1, at 99. The Exchange has represented that trading in cash-settled FLEX ETF Options will not commence until the related reporting requirements are finalized. See Amendment No. 1, at note 234.

³⁸⁵ See Amendment No. 1, at 97–98. Among other things, the Exchange noted that its regulatory program included cross-market surveillance designed to identify manipulative and other improper trading, including spoofing, algorithm gaming, marking the close and open, as well as more general abusive behavior related to front running, wash sales, quoting/routing, and Reg SHO violations, that may occur on the Exchange and other markets. Furthermore, the Exchange stated that it has access to information regarding trading activity in the pertinent underlying securities as a member of ISG. See Amendment No. 1, at note 317.

³⁸⁶ See Amendment No. 1, at 95.

it does not operate a physical trading floor and that the System and the proposed FLEX auction mechanisms will receive all FLEX Orders and FLEX responses electronically through remote terminals or computer-to-computer interfaces.³⁹¹ The Exchange also represents that FLEX Orders and FLEX Responses for covered accounts from Members will be transmitted from a remote location directly to the proposed auction mechanisms by electronic means. Therefore, the Commission believes that the proposed FLEX auction mechanisms satisfy the off-floor transmission requirement.

Second, the Rule requires that the member and any associated person not participate in the execution of its order after the order has been transmitted. The Exchange represents that at no time following the submission of an order is a Member or any associated person of such Member able to acquire control or influence over the result or timing of the order's execution.³⁹² According to the Exchange, execution of a FLEX Order (including the Agency and Initiating or Solicited Order, as applicable) or a FLEX response sent to the applicable auction mechanism depends not on the Member entering the FLEX Order or FLEX response, but rather on what other FLEX responses are present and the priority of those FLEX responses.³⁹³

2001), 66 FR 55225 (November 1, 2001) (SR-PCX-00-25) (approving Archipelago Exchange); 29237 (May 24, 1991), 56 FR 24853 (May 31, 1991) (SR-NYSE-90-52 and SR-NYSE-90-53) (approving NYSE's Off-Hours Trading Facility); and 15533 (January 29, 1979), 44 FR 6084 (January 31, 1979) ("1979 Release").

³⁹¹ See Amendment No. 1, at 141.

³⁹² See Amendment No. 1, at 142-3 (also representing, among other things, that no Member, including the Member submitting the FLEX Order into the applicable FLEX auction mechanisms, will see FLEX responses submitted into any of the FLEX auction mechanisms and therefore will not be able to influence or guide the execution of their FLEX Orders or FLEX responses, as applicable).

³⁹³ See Amendment No. 1, at 142. The Exchange also states that the submitting Member may cancel a FLEX Auction prior to the end of the exposure interval. See proposed Options 3A, Section 11(b)(2)(C). Members may modify or cancel FLEX responses during the exposure interval. See Options 3A, Section 11(b)(2)(D)(v). An Initiating Member may not cancel or modify an Agency Order or Initiating Order after it has been submitted into FLEX PIM, except to improve the price of the Initiating Order. See proposed Options 3A, Section 12(c)(4). Members may modify or cancel their responses after being submitted into a FLEX PIM. See proposed Options 3A, Section 12(c)(5)(F). An Initiating Member may not modify an Agency Order or Solicited Order after it has been submitted into FLEX SOM. See proposed Options 3A, Section 13(c)(4). Members may modify or cancel their responses after being submitted into a FLEX SOM. See proposed Options 3A, Section 12(c)(5)(F). The Commission has stated that the non-participation condition is satisfied under such circumstances so long as such modifications or cancellations are also transmitted from off the floor.

Accordingly, the Commission believes that a member does not participate in the execution of an order submitted to the proposed FLEX auction mechanisms.

Third, Rule 11a2-2(T) requires that the order be executed by an exchange member who is unaffiliated with the member initiating the order. The Commission has stated that this requirement is satisfied when automated exchange facilities, such as the FLEX Auction, FLEX PIM, and FLEX SOM, are used, as long as the design of these systems ensures that members do not possess any special or unique trading advantages in handling their orders after transmitting them to the exchange.³⁹⁴ ISE represents that the auctions are designed so that no Member has any special or unique trading advantage in the handling of its orders after transmitting its orders to the mechanism.³⁹⁵ Based on the Exchange's representation, the Commission believes that the proposed FLEX auction mechanisms satisfy this requirement.

Fourth, in the case of a transaction effected for an account with respect to which the initiating member or an associated person thereof exercises investment discretion, neither the initiating member nor any associated person thereof may retain any compensation in connection with effecting the transaction, unless the person authorized to transact business for the account has expressly provided otherwise by written contract referring to Section 11(a) of the Act and Rule 11a2-2(T) thereunder.³⁹⁶ ISE represents

See Securities Exchange Act Release No. 14563 (March 14, 1978), 43 FR 11542 (March 17, 1978) ("1978 Release") (stating that the "non-participation requirement does not prevent initiating members from canceling or modifying orders (or the instructions pursuant to which the initiating member wishes orders to be executed) after the orders have been transmitted to the executing member, provided that any such instructions are also transmitted from off the floor").

³⁹⁴ In considering the operation of automated execution systems operated by an exchange, the Commission noted that, while there is not an independent executing exchange member, the execution of an order is automatic once it has been transmitted into the system. Because the design of these systems ensures that members do not possess any special or unique trading advantages in handling their orders after transmitting them to the exchange, the Commission has stated that executions obtained through these systems satisfy the independent execution requirement of Rule 11a2-2(T). See 1979 Release.

³⁹⁵ See Amendment No. 1, at 143.

³⁹⁶ In addition, Rule 11a2-2(T)(d) requires a member or associated person authorized by written contract to retain compensation, in connection with effecting transactions for covered accounts over which such member or associated persons thereof exercises investment discretion, to furnish at least annually to the person authorized to transact business for the account a statement setting forth

that Members relying on Rule 11a2-2(T) for transactions effected through the proposed FLEX auction mechanisms must comply with this condition of the Rule and that the Exchange will enforce this requirement pursuant to its obligations under Section 6(b)(1) of the Act to enforce compliance with federal securities laws.³⁹⁷

D. Surveillance and Regulation

The Commission believes that surveillance is important, among other things, to detect and deter fraudulent and manipulative trading activity as well as other violations of Exchange rules and the federal securities laws. The Exchange has stated that it has an adequate surveillance program and will be integrating FLEX Options and their symbols into the existing surveillance system and processes. The Exchange believes this will allow the Exchange to properly identify disruptive and/or manipulative activity. The Exchange has also represented that it has taken into consideration that FLEX Options have unique characteristics and has reviewed its catalog of patterns and updated a number of patterns to include FLEX Options transactions when they begin trading. In addition, the Exchange has represented that it will periodically review its surveillance procedures and make any changes that the Exchange believes are necessary for FLEX trading. Furthermore, the Exchange represents that it believes it and the Options Price Reporting Authority ("OPRA") have the necessary systems capacity to handle the additional message traffic associated with the listing of new series that may result from the introduction of FLEX Options.³⁹⁸

The Exchange's proposed regulatory structure raises no new regulatory issues. As discussed above, the Exchange states that the FLEX provisions will be Systems enforced such that the system will reject an order if it does not conform to the FLEX rules. The Exchange has also incorporated FLEX Options into its surveillance program to cover it says the few instances where it will not Systems

the total amount of compensation retained by the member or any associated person thereof in connection with effecting transactions for the account during the period covered by the statement. See 17 CFR 240.11a2-2(T)(d). See also 1978 Release, at 11548 (stating "[t]he contractual and disclosure requirements are designed to assure that accounts electing to permit transaction-related compensation do so only after deciding that such arrangements are suitable to their interests").

³⁹⁷ See Amendment No. 1, at 144.

³⁹⁸ See Amendment No. 1, at 80. The Exchange noted that it will report FLEX Equity Options trades and, if necessary, trade cancels to OPRA. See Amendment No. 1, note 231.

enforce and to detect manipulative and illegal activity and will periodically review its surveillance to see if changes will be needed for FLEX. Accordingly, the Commission finds that the Exchange's proposed regulatory structure, including the Exchange's proposed application of its existing rules along with the proposed rule changes and the updates to its surveillance program to monitor issues unique to FLEX trading are consistent with the Exchange Act and, in particular, the Section 6(b)(5) requirement that a national securities exchange's rules be designed to prevent fraudulent and manipulative acts and practices; promote just and equitable principles of trade, and protect investors and the public interest.³⁹⁹ The Commission also finds that the Exchange's proposed regulatory structure is consistent with the requirements of Section 6(b)(1) of the Exchange Act, which requires a national securities exchange to be so organized and have the capacity to be able to carry out the purposes of the Exchange Act and to comply, and to enforce compliance by its members and persons associated with its members, with the Exchange Act and the rules and regulations thereunder, and the rules of the Exchange.⁴⁰⁰

IV. Solicitation of Comments on Amendment No. 1 to the Proposed Rule Change

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule change, as modified by Amendment No. 1, is consistent with the Exchange Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's internet comment form (<https://www.sec.gov/rules/sro.shtml>); or
- Send an email to rule-comments@sec.gov. Please include file number SR-ISE-2024-12 on the subject line.

Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090. All submissions should refer to file number SR-ISE-2024-12. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use

only one method. The Commission will post all comments on the Commission's internet website (<https://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 a.m. and 3 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. Do not include personal identifiable information in submissions; you should submit only information that you wish to make available publicly. We may redact in part or withhold entirely from publication submitted material that is obscene or subject to copyright protection. All submissions should refer to file number SR-ISE-2024-12 and should be submitted on or before December 20, 2024.

V. Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 1

The Commission finds good cause to approve the proposed rule change, as modified by Amendment No. 1 prior to the thirtieth day after the date of publication of notice of the filing of Amendment No. 1 in the **Federal Register**. The Commission notes that the original proposal was published for comment in the **Federal Register**.⁴⁰¹

In Amendment No. 1, the Exchange amended the proposal to make a number of clarifying changes to the proposal and the proposed rule text as well as the following more substantive rule text changes from the original filing: (i) excluding the iShares Bitcoin Trust ETF from FLEX trading in proposed Options 3A, Section 3(a); (ii) clarifying in proposed Options 3A, Section 3(b)(2) that on the expiration date, a FLEX Order for the expiring FLEX Option series may only be submitted to close out a position in such expiring FLEX Option series; (iii) aligning the Exchange's closing only provisions in proposed Options 3A, Section 3(d)(2) to already effective rules of other options exchanges; (iv)

clarifying in proposed Options 3A, Section 5 which provisions will govern how the minimum increments for complex FLEX Orders (including complex FLEX Orders with a stock component) will be handled; (v) clarifying in proposed Options 3A, Sections 6(a) and 6(b) that only the specified order types, times-in-force, and order and quote protocols are available for FLEX trading; (vi) removing in proposed Options 3A, Section 7(b) the Exchange's discretion to determine on a class-by-class basis which complex FLEX Orders would not have to adhere to the ratio requirements for the standard complex market; (vii) adding language in proposed Options 3A, Section 11(a)(2)(A) to describe what would happen if there is a complex FLEX Order and subsequently, a non-FLEX Option series is introduced for the component leg(s), which would align to already effective rules of another options exchange; (viii) adding language in proposed Options 3A, Sections 12(a)(2) and 13(a)(2) that each leg of a complex FLEX Order must be in a permissible FLEX option series that complies with proposed Options 3; (ix) specifying in proposed Options 3A, Section 13(a)(4) that the minimum size requirement will apply to each leg of a complex FLEX Order; (x) adding in proposed Options 3A, Section 14(b) that the Price Limit for Complex Order protections as applicable to the stock component, the Stock-Tied NBBO protections, and the Stock-Tied Reg SHO protections will also be available to FLEX Options as complex order risk protections; and (xi) aligning the proposed position limits for FLEX Index Options in proposed Options 3A, Section 18(a) with the position limits for index options in the Exchange's standard index options market. These changes help to clarify the proposal by providing additional specificity and justification about the proposal as well as making the proposed rule substantially similar to the existing rules of other national securities exchanges.

For these reasons, the changes and additional information in Amendment No. 1 assist the Commission in evaluating the Exchange's proposal and in determining that it is consistent with the Exchange Act. Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Exchange Act,⁴⁰² to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

³⁹⁹ See 15 U.S.C. 78f(b)(5).

⁴⁰⁰ 15 U.S.C. 78f(b)(1).

⁴⁰¹ See Notice, *supra* note 3; OIP, *supra* note 11.

⁴⁰² 15 U.S.C. 78f(b)(2).

VI. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the Exchange Act and the rules and regulations thereunder applicable to a national securities exchange. In addition, the Commission finds, pursuant to Rule 9b-1 under the Exchange Act, that FLEX Options are standardized options for purposes of the options disclosure

framework established under Rule 9b-1 of the Exchange Act.⁴⁰³

It is therefore ordered, pursuant to Section 19(b)(2) of the Exchange Act,⁴⁰⁴

⁴⁰³ 17 CFR 240.9b-1(a)(4). As part of the original approval process of the FLEX Options framework, the Commission delegated to the Director of the Division of Market Regulation the authority to authorize the issuance of orders designating securities as “standardized options” pursuant to Rule 9b-1(a)(4) under the Act. *See* Securities Exchange Act Release No. 31911 (February 23, 1993), 58 FR 11792 (March 1, 1993).

⁴⁰⁴ 15 U.S.C. 78s(b)(2).

that the proposed rule change SR-ISE-2024-12, as modified by Amendment No. 1, be, and it hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴⁰⁵

Sherry R. Haywood,

Assistant Secretary.

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⁴⁰⁵ 17 CFR 200.30-3(a)(12).