



SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-83039; File No. SR-PEARL-2018-02]

Self-Regulatory Organizations; MIAX PEARL, LLC; Order Granting Approval of a Proposed Rule Change to Adopt Rules Relating to Index Options

April 12, 2018

I. Introduction

On February 8, 2018, MIAX PEARL, LLC (“MIAX PEARL” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to adopt rules relating to index options. The proposed rule change was published for comment in the *Federal Register* on February 27, 2018.³ The Commission received no comments regarding the proposal. This order approves the proposed rule change.

II. Description of the Proposal

A. Overview

The Exchange proposes to amend MIAX PEARL Rule 504 and adopt new Chapter XVIII to accommodate the trading of index options on the Exchange by MIAX PEARL Members; and establish generic listing standards and maintenance standards to permit the Exchange to list “broad-based” and “narrow-based” index options on the Exchange pursuant to Rule 19b-4(e)

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 82756 (February 21, 2018), 83 FR 8538 (“Notice”).

under the Act.⁴ Proposed MIAX PEARL Chapter XVIII would incorporate by reference Chapter XVIII of the rules of the Exchange’s affiliate, Miami International Securities Exchange, LLC (“MIAX Options”).⁵ The proposed generic listing and maintenance standards for broad-based indices listed and traded on the Exchange require, among other things, that options on the index be a.m.-settled; that the index be capitalization-weighted, modified capitalization-weighted, price-weighted, or equal dollar-weighted; and that the index be comprised of at least fifty securities, all of which must be “NMS stocks,” as defined in Rule 600 of Regulation NMS.⁶ The proposed generic listing and maintenance standards for narrow-based indices require, among other characteristics, that the proposed indices must consist of ten or more component securities.⁷

Because the rules related to options in indices are product specific in many areas,⁸ certain rules will indicate that they apply to “Specified” indices. Proposed Rules 1800, 1801(n),

⁴ 17 CFR 240.19b-4(e). The term “broad-based index” is defined as an index designed to be representative of a stock market as a whole or of a range of companies in unrelated industries. See Proposed Rule 1801(k). The term “narrow-based index” is defined as an index designed to be representative of a particular industry or a group of related industries or an index whose constituents are all headquartered within a single country. See Proposed Rule 1801(j).

⁵ The Commission has separately issued an order granting the Exchange an exemption pursuant to Section 36(a) of the Act from the rule filing requirements of Section 19(b) of the Act with respect to the rules in MIAX Options Chapter XVIII that the Exchange seeks to incorporate by reference. See Securities Exchange Act Release No. 83040 (April 12, 2018). See also Securities Exchange Act Release No. 81739 (September 27, 2017), 82 FR 46111 (October 3, 2017) (order approving SR-MIAX-2017-39) (“MIAX Options Order”). The Commission notes that the MIAX Options Order also approved changes to MIAX Options Rules 308, 313, and 700, which rules are already incorporated by reference in MIAX PEARL’s rules. See id. at 46112 & nn. 13 & 15. See also Notice, supra note 3, at 8539. In the description of the proposed rule change below, the term “Proposed Rule” shall refer to the rules in MIAX Options Chapter XVIII, which the Exchange has proposed to be incorporated by reference into the MIAX PEARL Rules and thereby become applicable to MIAX PEARL Members.

⁶ See Proposed Rule 1802(d)(4).

⁷ See Proposed Rule 1802(b)(2).

⁸ See Notice, supra note 3, at 8539.

1804(a), 1807(a), 1809, and 1811 all contain provisions that are dependent upon the Exchange identifying specific index products in the rule. Accordingly, Proposed Rule 1800 states that where the rules in Chapter XVIII indicate that particular indices or requirements with respect to particular indices will be “Specified,” the Exchange will file a proposed rule change with the Commission pursuant to Section 19 of the Act⁹ and Rule 19b-4¹⁰ thereunder to specify such indices or requirements. Because MIAX PEARL has incorporated the rules in MIAX Options Chapter XVIII by reference, MIAX PEARL’s rules will be amended when MIAX Options files a proposed rule change with the Commission pursuant to Section 19 of the Act¹¹ and Rule 19b-4¹² thereunder to specify such indices or requirements.¹³ As more fully set forth in the Notice and further described below, the proposed new Exchange Rules are based on the existing rules of other options exchanges.¹⁴

B. Index Options Procedural Rules

MIAX PEARL proposes to add new Chapter XVIII to the Exchange rules (“Proposed Rules”), which would incorporate by reference the rules in Chapter XVIII of MIAX Options.¹⁵ The proposal would, among other things, set forth general procedural rules that address the

⁹ 15 U.S.C. 78s.

¹⁰ 17 CFR 240.19b-4.

¹¹ 15 U.S.C. 78s.

¹² 17 CFR 240.19b-4.

¹³ See Notice, supra note 3, at 8539. See also supra note 5.

¹⁴ See, e.g., MIAX Options Rules Chapter XVIII; Nasdaq ISE, LLC (“ISE”) Rules, Chapter 20, Index Rules; Nasdaq GEMX, LLC Rules, Chapter 20, Index Rules; Nasdaq MRX, LLC Rules, Chapter 20, Index Rules; NASDAQ PHLX LLC (“Phlx”) Rules 1000A-1108A; and Chicago Board Options Exchange, Inc. (“CBOE”) Rules, Chapter XXIV, Index Options; Cboe C2 Exchange, Inc. Rules, Chapter 24, Index Options. See also Notice, supra note 3, at 8539.

¹⁵ The Exchange also proposes to amend MIAX PEARL Rule 504 (Trading Halts) to address index options.

trading sessions for index options, including the days and hours of business, opening rotation, and halts and suspensions.¹⁶ Existing MIAX PEARL Rules further provide for the procedures Members must follow with respect to the exercise of American-style, cash settled index options.¹⁷

The Proposed Rules also establish position limit and exercise limits for index options.¹⁸ In addition, existing MIAX PEARL Rules and the Proposed Rules provide for exemption standards from position limits and procedures for requesting exemptions from those rules.¹⁹ The proposed position limits and exercise limits, as well as the proposed exemptions, are different for broad-based index options and narrow-based index options.²⁰

C. Generic Listing Standards and Maintenance Standards for Broad-Based Index Options

The Exchange also proposes to establish generic listing and maintenance standards in Proposed Rule 1802 to enable the Exchange to list and trade new broad-based index options pursuant to Rule 19b-4(e) under the Act.²¹ Proposed Rule 1802(d) sets forth the initial listing standards for broad-based index options. The listing standards require, among other things, that

¹⁶ See Proposed Rule 1808.

¹⁷ See MIAX PEARL Rules 313(a)(3) and 700(h). See also *supra* note 5.

¹⁸ See Proposed Rules 1804, 1805, and 1807.

¹⁹ See MIAX PEARL Rule 308(b) and Proposed Rule 1806. See also *supra* note 5.

²⁰ See Proposed Rules 1804 to 1807.

²¹ 17 CFR 240.19b-4(e). Rule 19b-4(e) provides that the listing and trading of a new derivative securities product by a self-regulatory organization (“SRO”) shall not be deemed a proposed rule change, pursuant to paragraph (c)(1) of Rule 19b-4, if the Commission has approved, pursuant to Section 19(b) of the Act, the SRO’s trading rules, procedures, and listing standards for the product class that includes the new derivative securities product and the SRO has a surveillance program for the product class. When relying on Rule 19b-4(e), the SRO must submit Form 19b-4(e) to the Commission within five business days after the exchange begins trading the new derivative securities products. See Securities Exchange Act Release No. 40761 (December 8, 1998), 63 FR 70952 (December 22, 1998) (File No. S7-13-98).

the underlying index be broad-based, as defined in Rule 1801(k); that options on the index be a.m. settled; that the index be capitalization-weighted, modified capitalization-weighted, price-weighted, or equal dollar-weighted; and that the index consist of 50 or more component securities, each of which must be an “NMS stock” as defined in Rule 600 of Regulation NMS under the Act.²² In addition, Proposed Rule 1802(d) requires that the index’s component securities meet certain minimum market capitalization and average daily trading volume requirements; that no single component account for more than 10% of the weight of the index and that the five highest weighted component securities represent no more than 33% of the weight of the index; that the index value be widely disseminated at least once every 15 seconds; and that the Exchange have written surveillance procedures in place with respect to the index options. Proposed Rule 1802(e) establishes maintenance standards for broad-based index options listed pursuant to Proposed Rule 1802(d). The Exchange states that the proposed listing and maintenance standards are modeled after standards approved by the Commission for other options exchanges.²³

D. Generic Listing Standards and Maintenance Standards for Narrow-Based Index Options

The Exchange further proposes to establish generic listing and maintenance standards in Proposed Rule 1802 to enable the Exchange to list and trade new narrow-based index options pursuant to Rule 19b-4(e) under the Act.²⁴ Proposed Rule 1802(b) sets forth the initial listing standards for narrow-based index options. The listing standards require, among other things, that

²² See 17 CFR 242.600.

²³ See, e.g., MIAX Options Rule 1802(d); NYSE American LLC (“NYSE American”) Rule 901C.02(a) and (b); CBOE Rule 24.2(f) and (g); NYSE Arca, Inc. (“NYSE Arca”) Rule 5.12-O; Phlx Rule 1009A(d) and (e); and ISE Rule 2002(d) and (e).

²⁴ 17 CFR 240.19b-4(e). See also supra note 21.

options on the index be a.m. settled; that the index be capitalization-weighted, price-weighted, equal dollar-weighted, or modified capitalization-weighted; and that the index consist of 10 or more component securities, each of which must be an “NMS stock” as defined in Rule 600 of Regulation NMS under the Act.²⁵ In addition, Proposed Rule 1802(b) requires that the index’s component securities meet certain minimum market capitalization and average daily trading volume requirements; that no single component account for more than 30% of the weight of the index and that the five highest weighted component securities represent no more than 50% (65% for an index consisting of fewer than 25 component securities) of the weight of the index; that the index value be widely disseminated at least once every 15 seconds; and that non-U.S. component securities (stocks or ADRs) that are not subject to comprehensive surveillance agreements do not in the aggregate represent more than 20% of the weight of the index. Proposed Rule 1802(c) establishes maintenance standards for narrow-based index options listed pursuant to Proposed Rule 1802(b). The Exchange states that the proposed listing and maintenance standards are modeled after standards approved by the Commission for other options exchanges.²⁶

E. Surveillance and Capacity

The Exchange represents that it has an adequate surveillance program in place for index options. The Exchange is a member of the Intermarket Surveillance Group (“ISG”), which is comprised of an international group of exchanges, market centers, and market regulators.²⁷ The

²⁵ See 17 CFR 242.600.

²⁶ See, e.g., MIAX Options Rule 1802(b) and (c); NYSE American Rule 901C.03; CBOE Rule 24.2(b) and (c); NYSE Arca Rule 5.13-O; Phlx Rule 1009A(b) and (c); and ISE Rule 2002(b) and (c).

²⁷ See Notice, supra note 3, at 8552. The ISG was formed on July 14, 1983, to, among other things, coordinate more effectively surveillance and investigative information sharing arrangements in the stock and options markets. The purpose of the ISG is to

Exchange further represents that it has analyzed its capacity and believes the Exchange and the Options Price Reporting Authority (“OPRA”) have the necessary systems capacity to handle the additional traffic associated with the listing and trading of index options.²⁸

F. Implementation

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

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, with Section 6(b) of the Act.²⁹ In particular, the Commission believes that the Exchange’s proposal to establish rules and procedures applicable to index options and establish generic listing and maintenance standards for broad-based and narrow-based index options is consistent with Section 6(b)(5) of the Act,³⁰ 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,

provide a framework for the sharing of information and the coordination of regulatory efforts among exchanges trading securities and related products to address potential intermarket manipulations and trading abuses. Id. The ISG plays a crucial role in information sharing among markets that trade securities, options on securities, security futures products, and futures and options on broad-based security indexes. Id.

²⁸ See id.

²⁹ 15 U.S.C. 78f(b). In approving this proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

³⁰ 15 U.S.C. 78f(b)(5). See also supra note 5.

to remove impediments to and perfect the mechanisms of a free and open market and a national market system and, in general, to protect investors and the public interest.

The Commission believes that permitting the trading of options on an index of securities (including a narrow-based index) enables investors to participate in the price movements of the index's underlying securities and allows investors holding positions in some or all of such securities to hedge the risks associated with their portfolios. The Commission further believes that options on an index provide investors with an important trading and hedging mechanism that is designed to reflect accurately the overall movement of the component stocks. In particular, the Commission believes that the proposed position and exercise limits should serve to minimize potential manipulation concerns.

A. Generic Listing and Maintenance Standards for Broad-Based and Narrow-Based Index Options

In considering the proposed generic listing and maintenance standards for broad-based and narrow-based index options, the Commission notes that they are consistent with the listing and maintenance standards for broad-based and narrow-based index options that other exchanges³¹ have developed and that the Commission has previously approved.³² The Commission finds that the generic standards covering minimum capitalization, monthly trading

³¹ See, e.g., MIAX Options Rules Chapter XVIII; NYSE American Rules 901C.02 and 901C.03; CBOE Rule 24.2; NYSE Arca Rules 5.12-O and 5.13-O; Phlx Rule 1009A; and ISE Rule 2002.

³² See, e.g., MIAX Options Order, *supra* note 5 (order approving rules for index options, including generic listing and maintenance standards for broad-based and narrow-based index options); Securities Exchange Act Release Nos. 48405 (August 25, 2003), 68 FR 52257 (September 2, 2003) (SR-ISE-2003-05) (order approving rules for index options and generic listing and maintenance standards for narrow-based index options); 52578 (October 7, 2005), 70 FR 60590 (October 18, 2005) (SR-ISE-2005-27) (order approving generic listing and maintenance standards for broad-based index options); and 75650 (August 7, 2015), 80 FR 48600 (August 13, 2015) (SR-EDGX-2015-18) (order approving options trading rules, including generic listing and maintenance standards for broad-based and narrow-based index options).

volume, and relative weightings of component stocks are designed to ensure that the trading markets for component stocks are adequately capitalized and sufficiently liquid, and that no one stock or stock group dominates the index. Thus, the Commission believes that the satisfaction of these requirements significantly minimizes the potential for manipulation of the index.

The Commission also finds the requirements that all securities comprising the index be an “NMS stock” as defined in Rule 600 of Regulation NMS under the Act,³³ and that the index value be disseminated at least once every 15 seconds during trading hours of the index, will contribute significantly to the transparency of the market for such index options.

The Commission further notes that the Exchange’s rules that are applicable to broad-based and narrow-based index options, including provisions addressing sales practices, floor trading procedures, position and exercise limits, margin requirements, and trading halts and suspensions, will continue to apply to any broad-based or narrow-based index options listed pursuant to Rule 19b-4(e) under the Act.

The Commission’s approval of the Exchange’s proposed listing standards for broad-based and narrow-based index options will allow those index option products that satisfy the generic listing standards to begin trading pursuant to Rule 19b-4(e) under the Act, without the need for notice and comment and Commission approval. The Exchange’s ability to rely on Rule 19b-4(e) under the Act for these products potentially reduces the time frame for listing and trading these securities, and thus enhances investors’ opportunities.³⁴

B. Surveillance

³³ See 17 CFR 242.600.

³⁴ The Exchange, however, must maintain regulatory oversight over any products listed under the generic listing standards through adequate surveillance. The Exchange represents that it has an adequate surveillance program in place for index options. See Notice, supra note 3, at 8552.

As noted above,³⁵ the Commission believes that the Exchange must maintain regulatory oversight over any products listed under the generic listing standards through adequate surveillance, and the Exchange represents that it has an adequate surveillance program in place for index options. The Commission also believes that a surveillance sharing agreement between an Exchange proposing to list a stock index derivative product and the exchange(s) trading the stocks underlying the derivative product is an important measure for surveillance of the derivative and underlying securities markets. The Commission notes that such agreements ensure the availability of information necessary to detect and deter potential manipulations and other trading abuses, thereby making the stock index product less readily susceptible to manipulation. When a new derivative securities product based upon domestic securities is listed and traded on an exchange pursuant to Rule 19b-4(e) under the Act, the exchange should determine that the markets upon which all of the U.S. component securities trade are members of the ISG, which provides information relevant to the surveillance of the trading of securities on other market centers.³⁶ In this regard, all of the registered national securities exchanges, including the Exchange, as well as the Financial Industry Regulatory Authority (FINRA), are members of the ISG.

For new derivative securities products based on securities from a foreign market, the SRO should have a comprehensive Intermarket Surveillance Agreement with the market for the securities underlying the new securities product.³⁷ Accordingly, the Commission finds that the requirement that no more than 20% of the weight of the index may be comprised of non-U.S.

³⁵ See supra note 34.

³⁶ See Securities Exchange Act Release No. 40761 (December 8, 1998), 63 FR 70952 (December 22, 1998) (File No. S7-13-98).

³⁷ Id.

component securities (stocks or ADRs) that are not subject to a comprehensive surveillance sharing agreement between the particular U.S. exchange and the primary market of the underlying security will continue to ensure that the Exchange has the ability to adequately surveil trading in the broad-based and narrow-based index options and the ADR components of the index.³⁸

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,³⁹ that the proposed rule change (SR-PEARL-2018-02), be and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴⁰

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³⁸ See Proposed Rule 1802(b)(9) and (d)(10).

³⁹ 15 U.S.C. 78s(b)(2).

⁴⁰ 17 CFR 200.30-3(a)(12).

