

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-83033; File No. SR-Phlx-2018-14)

April 11, 2018

Self-Regulatory Organizations; Nasdaq PHLX LLC; Order Approving a Proposed Rule Change, as Modified by Amendment Nos. 1, 2, and 3, to Adopt Protections for Butterfly Spreads and Box Spreads

I. Introduction

On February 9, 2018, Nasdaq PHLX LLC (“Phlx” or the “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend Phlx Rule 1098, “Complex Orders on the System,” to adopt protections for Complex Orders that are box spreads or butterfly spreads.<sup>3</sup> On February 21, 2018, the Exchange filed Amendment No. 1 to the proposed rule change, which superseded the original filing in its entirety. The proposed rule change, as modified by Amendment No. 1, was published for comment in the Federal Register on March 1, 2018.<sup>4</sup> On April 9, 2018, the Exchange filed Amendment No. 2 to the proposal. On April 10, 2018, the Exchange filed Amendment No. 3 to the proposal, which superseded Amendment No. 2 in its entirety.<sup>5</sup> The Commission received no

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

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

<sup>3</sup> For purposes of the electronic trading of Complex Orders, a “Complex Order” is an order involving the simultaneous purchase and/or sale of two or more different options series in the same underlying security, priced as a net debit or credit based on the relative prices of the individual components, for the same account, for the purpose of executing a particular investment strategy. See Phlx Rule 1098(a)(i).

<sup>4</sup> See Securities Exchange Act Release No. 82766 (February 23, 2018), 83 FR 8914 (March 1, 2018) (“Notice”).

<sup>5</sup> In Amendment No. 3, the Phlx revised the proposal to (1) replace references in proposed Phlx Rule 1098(i)(i) to “Complex Order” with “Butterfly Spread,” and to “Complex Market Order” with “Butterfly Spread entered as a Market Order;” (2) revise proposed Phlx Rule 1098(i)(i)(a) to indicate that the Initial Maximum Value is the distance

comments regarding the proposed rule change. This order approves the proposed rule change, as modified by Amendment Nos. 1, 2, and 3.

II. Description of the Proposed Rule Change, as Modified by Amendment Nos. 1, 2, and 3

As described more fully in the Notice, the Exchange proposes to amend Phlx Rule 1098 to adopt protections that will prevent the execution of a butterfly spread<sup>6</sup> or a box spread<sup>7</sup> at a price outside of specified minimum and maximum values (the “Butterfly Spread Protection” and the “Box Spread Protection,” respectively).<sup>8</sup> Under the Butterfly Spread Protection, a butterfly spread that is priced higher than the Maximum Value<sup>9</sup> or lower than the Minimum Value<sup>10</sup> will

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between the strike price of the leg with the mid-point and either of the outer leg strike prices; (3) replace references in proposed Phlx Rule 1098(j)(i) to “Complex Order” with “Box Spread” and to “Complex Market Order” with “Box Spread entered as a Market Order;” (4) amend proposed Phlx Rules 1098(i)(i) and (j)(i) to refer to “an order being auctioned,” rather than an “auction;” and (5) delete the reference to “spread” in proposed Phlx Rule 1098(j)(i)(b). Because Amendment No. 3 makes only clarifying and technical changes, and does not present unique or novel regulatory issues, it is not subject to notice and comment.

<sup>6</sup> 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 proposed Phlx Rule 1098(i).

<sup>7</sup> 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 proposed Phlx Rule 1098(j).

<sup>8</sup> See Notice, 83 FR at 8915.

<sup>9</sup> For a butterfly spread, the Maximum Value is calculated by adding the Initial Maximum Value (the distance between strike price of the leg with the mid-point strike and either of the outer leg strike prices) and the Maximum Value Buffer. The Maximum Value Buffer is the lesser of a configurable absolute dollar value or percentage of the Initial Maximum Value set by the Exchange and announced via a notice to members. See proposed Phlx Rule 1098(i)(i)(a).

<sup>10</sup> For a butterfly spread, the Minimum Value is calculated by subtracting the Minimum Value Buffer (a configurable absolute dollar value set by the Exchange and announced

be cancelled. A butterfly spread entered as a market order will be accepted but will be restricted from trading at a price that is higher than the Maximum Value or lower than the Minimum Value.<sup>11</sup> Similarly, under the Box Spread Protection, a box spread that is priced higher than the Maximum Value<sup>12</sup> or lower than the Minimum Value<sup>13</sup> will be cancelled. A box spread entered as a market order will be accepted but will be restricted from trading at a price that is higher than the Maximum Value or lower than the Minimum Value.<sup>14</sup> The Butterfly Spread Protection and the Box Spread Protection apply to orders being auctioned and to auction responses, and they apply throughout the trading day, including during the pre-market, the opening process, and trading halts.<sup>15</sup>

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via a notice to members) from the Initial Minimum Value of zero. See proposed Phlx Rule 1098(i)(i)(b). The Phlx notes that the Minimum Value could be less than zero. See Notice, 83 FR at 8915. The Phlx states that a market participant seeking to trade out of a position at intrinsic value might not find a contra-side willing to trade without a premium. The Phlx notes that an incremental allowance outside of the minimum/maximum value would allow for a small premium to offset commissions associated with trading and could incentivize participants to take the other side of a spread trading at intrinsic value. The Phlx further notes that a participant might find it financially beneficial to pay a small premium to close out its position rather than carry the position to expiration and take delivery. See id.

<sup>11</sup> See proposed Phlx Rule 1098(i)(i).

<sup>12</sup> For a box spread, the Maximum Value is calculated by adding the Initial Maximum Value (the distance between the strike prices of each pair of leg strike prices) and the Maximum Value Buffer. The Maximum Value Buffer is the lesser of a configurable absolute dollar value or percentage of the Initial Maximum value set by the Exchange and announced via a notice to members. See proposed Phlx Rule 1098(j)(i)(a).

<sup>13</sup> For a box spread, the Minimum Value is calculated by subtracting the Minimum Value Buffer (a configurable absolute dollar value set by the Exchange and announced via a notice to members) from the Initial Minimum Value of zero. See proposed Phlx Rule 1098(j)(i)(b).

<sup>14</sup> See proposed Phlx Rule 1098(j)(i).

<sup>15</sup> See proposed Phlx Rules 1098(i)(i) and (ii), and 1098(j)(i) and (ii).

The Phlx states that the proposal is responsive to member input and will provide members with additional functionality that will assist them in managing risk.<sup>16</sup> In addition, the Phlx states that the buffer allowance from the minimum and maximum values permitted for the execution of butterfly and box spreads will provide market participants with flexibility to manage their business.<sup>17</sup> The Phlx notes that it currently offers similar order protection features for Complex Orders to avoid erroneous trades, including the Strategy Price Protection and the Acceptable Complex Execution (“ACE”) Parameter.<sup>18</sup>

### 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.<sup>19</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>20</sup> 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, 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 Commission believes that the Butterfly Spread Protection and the Box Spread Protection will help market participants mitigate risk by preventing the execution of butterfly and

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<sup>16</sup> See Notice, 83 FR at 8916.

<sup>17</sup> See id. at 8917.

<sup>18</sup> See id. at 8915. See also Phlx Rules 1098(g) (Strategy Price Protection) and 1098(h)(i) (ACE Parameter).

<sup>19</sup> 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).

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

box spreads at prices that are outside of specified minimum and maximum values. The Commission notes that the Phlx has indicated that the protections are responsive to input from Phlx members.<sup>21</sup> In addition, the Commission notes that another options exchange has adopted similar price protections.<sup>22</sup>

#### IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>23</sup> that the proposed rule change (SR-Phlx-2018-14), as modified by Amendment Nos. 1, 2, and 3, is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>24</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>21</sup> See Notice, 83 FR at 8916.

<sup>22</sup> See CBOE Rule 6.53C, Interpretation and Policy .08(g).

<sup>23</sup> 15 U.S.C. 78s(b)(2).

<sup>24</sup> 17 CFR 200.30-3(a)(12).