

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-70821; File No. SR-Phlx-2013-106)

November 6, 2013

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Notice of Filing of Proposed Rule Change to Amend Rules 1064 and 1080 to More Specifically Address the Number and Size of Counterparties to a Qualified Contingent Cross Order

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup>, and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on October 23, 2013, NASDAQ OMX PHLX LLC (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange is filing with the Commission a proposal to amend Rules 1064 and 1080 to more specifically address the number and size of counterparties to a Qualified Contingent Cross Order (“QCC Order”). The text of the proposed rule change is below. Proposed new language is underlined; deleted text is in brackets.

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**Rule 1064. Crossing, Facilitation and Solicited Orders**

(a) – (d) No change.

(e) A Floor Qualified Contingent Cross Order is comprised of an order to buy or sell at least 1,000 contracts, or 10,000 contracts in the case of Mini Options, that is identified as being part of

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

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

a qualified contingent trade, as that term is defined in subsection (3) below, coupled with a contra-side order or orders totaling [to buy or sell] an equal number of contracts.

(1) - (3) No change.

**Commentary**

01 - 04 No change.

\* \* \* \* \*

**Rule 1080. Phlx XL and Phlx XL II**

(a) – (n) No change.

**(o) Qualified Contingent Cross Order.**

A Qualified Contingent Cross Order is comprised of an order to buy or sell at least 1,000 contracts, or 10,000 contracts in the case of Mini Options, that is identified as being part of a qualified contingent trade, as that term is defined in subsection (3) below, coupled with a contra-side order or orders totaling [to buy or sell] an equal number of contracts.

(1) - (3) No change.

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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 the Statutory Basis

for, the Proposed Rule Change

1. Purpose

The purpose of the proposal is to expand the availability of QCC orders by permitting multiple counterparties on a QCC order, including permitting one individual counterparty to consist of an order for less than 1,000 contracts provided one side of the QCC order meets the 1,000 contract minimum (as well as the other requirements of a QCC Order). This is intended to accommodate multiple counterparties, as explained further below.

The Exchange currently permits two types of QCC Orders. Pursuant to Rule 1064(e), A Floor Qualified Contingent Cross Order (“Floor QCC Order”) is comprised of an order to buy or sell at least 1,000 contracts<sup>3</sup> that is identified as being part of a qualified contingent trade,<sup>4</sup> coupled with a contra-side order to buy or sell an equal number of contracts. Floor QCC Orders are immediately executed upon entry into the System by an Options Floor Broker provided that (i) no Customer Orders are at the same price on the Exchange's limit order book and (ii) the price is at or between the National Best Bid/Offer (“NBBO”). Floor QCC Orders are submitted into

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<sup>3</sup> In the case of Mini Options, the minimum size is 10,000 contracts.

<sup>4</sup> A "qualified contingent trade" is a transaction consisting of two or more component orders, executed as agent or principal, where: (a) At least one component is an NMS Stock, as defined in Rule 600 of Regulation NMS under the Exchange Act; (b) all components are effected with a product or price contingency that either has been agreed to by all the respective counterparties or arranged for by a broker-dealer as principal or agent; (c) the execution of one component is contingent upon the execution of all other components at or near the same time; (d) the specific relationship between the component orders (e.g., the spread between the prices of the component orders) is determined by the time the contingent order is placed; (e) the component orders bear a derivative relationship to one another, represent different classes of shares of the same issuer, or involve the securities of participants in mergers or with intentions to merge that have been announced or cancelled; and (f) the transaction is fully hedged (without regard to any prior existing position) as a result of other components of the contingent trade.

the System by Floor Brokers on the Floor via the Floor Broker Management System. Floor QCC Orders are automatically rejected if they cannot be executed.

In addition to Floor QCC Orders, Phlx offers automated Qualified Contingent Orders (“Automated QCC Order”). Pursuant to Rule 1080(o), an Automated QCC Order is very similar to a Floor QCC Order, in that it must be comprised of an order to buy or sell at least 1,000 contracts that is identified as being part of a qualified contingent trade, coupled with a contra-side order to buy or sell an equal number of contracts. Automated QCC Orders shall only be submitted electronically from off the Floor to the Phlx System. Automated QCC Orders are immediately executed upon entry into the System by an Order Entry Firm provided that (i) no Customer Orders are at the same price on the Exchange's limit order book and (ii) the price is at or between the NBBO. Automated QCC Orders will be automatically rejected if they cannot be executed.

Some Exchange members have requested the ability to submit both Floor and Automated QCC Orders involving multiple counterparties on one side of the trade where the contracts submitted total at least 1,000 contracts. Accordingly, the Exchange is proposing to change the definition of both types of QCC Orders to accommodate multiple counterparties. Each definition of a QCC Order is currently framed in the singular (...coupled with *a* contra-side order...), therefore, the Exchange would like to make it clear to its members and other participants that a QCC Order must involve a single order for 1,000 contracts on one side, but that it may consist of multiple orders on the opposite side.

For instance, a 5,000 contract QCC Order to buy could, under this proposal, be coupled with two orders to sell 2,500 contracts each. Similarly, a 5,000 contract order to buy would, under this proposal, be coupled with an order to sell 4,500 contracts and an order to sell 500

contracts. Each sell order need not be for a minimum of 1,000 contracts, provided that the total of all sell orders equals the size of the buy order and is at least 1,000 contracts. Accordingly, the Exchange is proposing to amend the definition of QCC Order to permit a single order to buy or sell at least 1,000 contracts on one side coupled with an order or orders totaling an equal number of contracts.

The Exchange understands that the International Securities Exchange (“ISE”) permits multiple counterparties on one side of a QCC to fulfill the 1,000 contract minimum.<sup>5</sup> Although the ISE and Phlx rules governing QCC Orders are identically-worded in relevant respects, Phlx has taken the opposite approach and required that both sides of a QCC Order be a single order of at least 1,000 contracts.

While the current ISE and Phlx rule language may be ambiguous regarding the practice of permitting multiple counter-parties on one side of the QCC Order, there is support for the practice in prior Commission orders. In approving QCC orders on another exchange,<sup>6</sup> the Commission noted that:

QCC Orders must be for 1,000 or more contracts, in addition to meeting all of the requirements of the NMS QCT Exemption. The Commission believes that those customers participating in QCC Orders will likely be sophisticated investors who should understand that, without a requirement of exposure for QCC Orders, their order would not be given an opportunity for price improvement on the Exchange. These customers should be able to assess whether the net prices they are receiving for their QCC Order are competitive, and who will have the ability to choose among broker-dealers if they believe the net price one broker-dealer provides is not competitive. Further, broker-dealers are subject to a duty of best execution for their customers’ orders, and that duty does not change for QCC Orders.<sup>7</sup>

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<sup>5</sup> But see CBOE RG13-041 at [http://cchwallstreet.com/CBOEtools/PlatformViewer.asp?SelectedNode=chp\\_1\\_1&manual=/CBOE/bulletins/cboe-reg-bull-2013/](http://cchwallstreet.com/CBOEtools/PlatformViewer.asp?SelectedNode=chp_1_1&manual=/CBOE/bulletins/cboe-reg-bull-2013/).

<sup>6</sup> See Securities Exchange Act Release No. 63955 (February 24, 2011), 76 FR 11533 (March 2, 2011)(SR-ISE-2010-73)(“QCC Approval Order”).

<sup>7</sup> QCC Approval Order at Section III.C.

Accordingly, the 1,000 contract buy order, for example, reflects the buying interest of a sophisticated investor while the multiple sellers, as proposed, are accommodating that buying interest.

Phlx notes that this potential ambiguity extends back to the original QCC Approval Order and to ISE's comment letter in support of it. In its discussion about the 1,000 contract requirement, the ISE stated:

“...CBOE questions how we calculate the 1,000 contract minimum for the QCC. Nothing could be clearer in our proposed rule: proposed ISE Rule 715(j) defines QCC as ‘an order to buy or sell at least 1,000 contracts that is identified as being part of a qualified contingent trade....’ This means what it says, that there must be an order to buy or sell 1,000 contracts that is part of a QCC - not two 500 orders, not two 500 legs, not anything but an order to buy or sell at least 1,000 contracts.”<sup>8</sup>

Despite this seemingly clear statement requiring a single order of at least 1,000 contracts on each side of a QCC Order, ISE currently permits members to satisfy the 1,000-contract requirement through a combination of multiple orders.

Rather than operate with ambiguity, the Exchange is filing this proposal to make clear that only one side (either the buy or the sell and not both) must meet the minimum 1,000 contract size requirement.

The Exchange is not proposing to limit this proposal to a single participant type, such as a customer. Today, QCC Orders are not limited this way. Neither side must be on behalf of a customer. The original ISE proposal was not crafted to be limited either; there is little mention of the word “customer.” To the contrary, the QCC Approval Order specifically contemplated

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<sup>8</sup> See letter from Michael J. Simon, Secretary, International Securities Exchange, to Elizabeth M. Murphy, Secretary, Commission, dated August 25, 2010 (Letter responding to CBOE comment on SR-ISE-2010-73).

“sophisticated investors” in citing the benefits of qualified contingent trades,<sup>9</sup> rather than “public customers” or “retail.” The Exchange believes that QCC Orders are used by and needed for all types of market participants, and this proposal to permit multiple counterparties would similarly be useful for all types of market participants.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>10</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>11</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest, by making the QCC Order more palatable to counterparties, thereby encouraging trading in multiple instruments. Specifically, because the proposal seeks to permit multiple counterparties, it should therefore provide more opportunity to participate in QCC trades, consistent with the key principles behind the QCC Order.

In approving QCC Orders, the Commission has stated that “...qualified contingent trades are of benefit to the market as a whole and a contribution to the efficient functioning of the securities markets and the price discovery process.”<sup>12</sup> The Commission “also has recognized that contingent trades can be useful trading tools for investors and other market participants, particularly those who trade the securities of issuers involved in mergers, different classes of shares of the same issuer, convertible securities, and equity derivatives such as options [emphasis

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<sup>9</sup> See supra note 7 and accompanying text.

<sup>10</sup> 15 U.S.C. 78f(b).

<sup>11</sup> 15 U.S.C. 78f(b)(5).

<sup>12</sup> QCC Approval Order at text accompanying footnote 115.

added].”<sup>13</sup> In light of these benefits, the Exchange believes that the proposal should improve the usefulness of the QCC Order without raising novel regulatory issues, because the proposal does not impact the fundamental aspects of this order type - it merely permits multiple counterparties on one side, while preserving the 1,000 contract minimum.

Consistent with Section 6(b)(8) of the Act, the Exchange seeks to compete with other options exchanges for QCC Orders involving multiple parties, including where one side of the order is for less than 1,000 contracts. The Exchange believes that this will be beneficial to participants because allowing multiple parties of any size on one side should foster competition for filling one side of a QCC Order and thereby result in potentially better prices.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. In fact, the proposal is intended to relieve a burden on competition, which results from different exchanges interpreting their rules differently. Among the options exchanges, the Exchange believes that the proposal to allow multiple parties of any size on one side should foster competition for filling one side of a QCC order and thereby result in potentially better prices for such orders.

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

No written comments were either solicited or received.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer

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<sup>13</sup> QCC Approval Order at Section III.A. citing Securities Exchange Act Release No. 54389 (August 31, 2006), 71 FR 52829 (September 7, 2006) (Original QCT Exemption).

period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove the proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

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

##### Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-Phlx-2013-106 on the subject line.

##### Paper comments:

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

All submissions should refer to File Number SR-Phlx-2013-106. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those

that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-Phlx-2013-106 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>14</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>14</sup> 17 CFR 200.30-3(a)(12).