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December 22, 2016

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: SR-CBOE-2016-082

Dear Mr. Fields:

The Nasdaq Stock Market LLC (“NOM”), Nasdaq PHLX LLC (“Phlx”), Nasdaq BX, Inc., International Securities Exchange, LLC (“ISE”), ISE Gemini, LLC (“ISE Gemini”), and ISE Mercury, LLC (“ISE Mercury”) options markets (collectively “Nasdaq”) respectfully submit this comment in response to a recent rule change by the Chicago Board Options Exchange, Incorporated (“CBOE”) to amend its rules to “...ensure compliance with open outcry priority and allocation requirements and Trade-Through prohibitions.”¹ While Nasdaq neither supports nor opposes the CBOE proposal, it respectfully submits that, today, options floor environments are operating without uniformity with respect to the application of priority and Trade-Through requirements. Nasdaq respectfully requests that the Securities and Exchange Commission articulate a clear principle governing the proper application of priority and Trade-Through requirements to floor trading in standardized options, and then apply that principle uniformly to all trading floors.

Priority, Allocation and Trade-Throughs On Floor

When considering the application of rules governing open outcry priority and allocation requirements and Trade-Through prohibitions, the market against which the trade is validated must first be established. While in the electronic environment the time of execution is established within the match engine, such time of execution in an open outcry environment differs among options venues offering floor trading. Floor trading necessarily requires the

¹ See Securities and Exchange Release Act No. 79540 (December 13, 2016), 81 FR 91967 (December 19, 2016) (SR-CBOE-2016-082) (Notice of Filing of a Proposed Rule Change Related to Rules Regarding the Responsibility for Ensuring Compliance With Open Outcry Priority and Allocation Requirements and Trade-Through Prohibitions).

exposure of an order within a trading crowd for purposes of price discovery and negotiation. Once a trade is negotiated in the trading crowd and there is a verbal agreement (“Verbal Agreement”) in that trading crowd, orders are memorialized for execution and dissemination to the tape (“Reported Trade”). Because of the human element present on the trading floor, particularly when dealing with complex orders, the Verbal Agreement and Reported Trade do not occur in tandem as with electronic trading. Each options market has rules which impact the market against which the trade is validated.

Regulation of Floor Trading

In considering the regulation of floor trading, Nasdaq believes

- Floor Brokers should be systematically prevented from violating priority and Trade-Through requirements.
- Exchange rules governing floor trading must be clear and transparent.
- Compliance with priority and Trade-Through requirements must consider a latency which allows for a floor transaction to be negotiated and then executed.
- The Commission should establish a standard for the interval of a tolerable latency and the requirement to memorialize the consummation in the crowd prior to the execution in the matching engine.

CBOE’s Proposal

CBOE’s proposal seeks to specify that the party or parties responsible for ensuring transactions are executed in accordance with the priority and allocation provisions and Trade-Through prohibitions is the initiator of the transaction when a Floor Broker is trading with a Market-Maker, both parties when a Floor Broker trades with a Floor Broker, and both parties when the transaction is between Market-Makers.² CBOE states in its rule change that Floor Brokers are in a good position to prevent Trade-Throughs and book priority violations because Floor Brokers may utilize the Public Automatic Routing System (“PAR”) to execute orders, which is not available to Market-Makers. PAR provides all of the necessary market data to avoid Trade-Throughs and book priority violations (*e.g.*, PAR includes data related to electronic public customer books, CBOE best bid and offer (“BBO”), and national best bid and offer (“NBBO”), etc.). In addition, PAR calculates and displays a net price for complex orders held by a Floor Broker. Most importantly, however, PAR offers alerts that warn Floor Brokers that a proposed execution price for a given order may violate priority or result in a potential Trade-Through. These alerts occur via pop-up windows within PAR.³

² Id. at 91968.

³ Id. at 91969.

CBOE applies a different standard to floor trading as compared to its electronic market in the enforcement of Trade-Throughs. While off-Floor trading is systematically prevented from violating priority and Trade-Through rules, on-Floor trading does not have similar protections as it relates to Floor Brokers. By comparison, Phlx's Floor Broker Management System or "FBMS" conducts compliance checks for priority and Trade-Through rules to prevent violations of its rules prior to execution.⁴ FBMS helps to ensure fair and orderly trading through the consistent application of priority and trade through rules to on-Floor trading. Phlx's FBMS model ensures consistency with respect to compliance checks utilized for both on-Floor and off-Floor trading. Phlx's FBMS mechanism and manner in which rule compliance is validated are expressly described in Phlx's Rules.⁵

It is unclear from CBOE's proposal the manner in which PAR operates and specifically which time CBOE utilizes to validate a trade for purposes of regulating priority and Trade-Through rules. Specifically, the CBOE rule proposal does not describe the process for validation of trades and whether validation occurs at the time of the Verbal Agreement or Reported Trade. Also, CBOE does not discuss the specific manner in which surveillance reviews transactions for violations of CBOE's rules. Enforcement of priority and Trade-Through rules ensures the protection of investors. Nasdaq believes that these issues should be addressed in the rule change because these factors are pertinent to establishing the standards by which CBOE floor members are held to in relation to Trade-Through and priority rules. In addition, these details are pertinent in providing its members clarity to the manner in which the Exchange surveils for and enforces priority and Trade-Through rules. It is unclear from CBOE's rules the manner in which PAR or CBOE enforce compliance for on-floor transactions.

Nasdaq notes that differential treatment proposed by CBOE creates both an intra-market competition and an inter-market competition. Today, Phlx's FBMS does not allow any Floor Broker to execute a transaction that would violate priority and Trade Through rules. Whereas, CBOE's PAR provides information to Floor Brokers to avoid Trade-Throughs and book priority violations, it does not systematically prevent them. Nasdaq believes CBOE's proposal has both

⁴ Specifically, when there is a Verbal Agreement and the trade is entered into FBMS and submitted to the Trading System (Reported Trade), the Trading System immediately compares the terms of the trade to the market prevailing at the time the trade was received by the Trading System. If the consummated trade violates either the trade through rule or applicable priority requirements based on conditions existing at the time of receipt by the Trading System, the Trading System will reject the trade back to the entering member. If the Trading System verifies that the trade complies with applicable trade-through and priority rules based on the market prevailing at the time of receipt by the Trading System, the Trading System will then execute the trade, and report the execution to the consolidated tape for dissemination to the public.

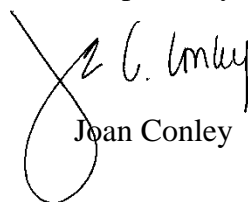
⁵ See Phlx Rule 1063.

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competitive and regulatory impact to other markets, specifically other venues that offer floor trading. Nasdaq's request for a clear principle governing the proper application of priority and Trade-Through requirements to floor trading in standardized options would address this inter-market disparity. Finally, Nasdaq requests the Commission clarify the appropriate amount of time allowable once there is a Verbal Agreement to have a Reported Trade to ensure that all options floor markets are standardized.

Nasdaq thanks the Commission for the opportunity to comment on this proposed rule filing. If you have any additional questions, or if we can be of further assistance in this matter, please do not hesitate to contact us.

Respectfully,



Joan Conley

cc: David Shillman, Associate Director, SEC Division of Trading and Markets
John Roeser, Associate Director, SEC Division of Trading and Markets
Tyler Raimo, SEC Division of Trading and Markets