

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-65469; File No. SR-Phlx-2011-108)

October 3, 2011

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Routing Functionality on NASDAQ OMX PSX

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 September 21, 2011, 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, II, and III, 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 proposes to add routing functionality to the NASDAQ OMX PSX facility of NASDAQ OMX PHLX (“System”). Specifically, the Exchange proposes to adopt new Rule 3315, Order Routing, and amend Rule 3301, Definitions, and Rule 3305, Order Entry Parameters, as described below. The Exchange intends to implement the proposal upon notice to its membership.

The text of the proposed rule change is available on the Exchange’s Website at <http://www.nasdaqtrader.com/micro.aspx?id=PHLXRulefilings>, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

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

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

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 purpose of the proposed rule change is to attract additional business to and enhance the functionality offered by PSX by providing optional outbound routing services. Most equities exchanges today provide routing services. The Exchange intends to offer routing strategies materially identical to several currently offered by its affiliate, The NASDAQ Stock Market, LLC (“NASDAQ”).<sup>3</sup> Nasdaq Execution Services LLC is NASDAQ’s routing broker and provides routing functions for NASDAQ. As described in detail below, the Exchange proposes to use Nasdaq Execution Services LLC as its routing broker to provide all of its PSX routing services as well. Specifically, the Exchange proposes to permit Nasdaq Execution Services LLC to route orders from PSX to all market centers, as it does for NASDAQ, including to NASDAQ and NASDAQ OMX BX (“BX”).<sup>4</sup>

First, PHLX proposes to amend two existing rules to accommodate routing. Specifically, PHLX proposes to amend subparagraph (f)(6) of Rule 3301, Definitions, which pertains to

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<sup>3</sup> See e.g., NASDAQ Rule 4758.

<sup>4</sup> PHLX’s other affiliate, BX, has also proposed to provide outbound routing services using NES as its routing broker. See SR-BX-2011-048.

Intermarket Sweep Orders (“ISOs”). These are currently defined as limit orders that are designated as ISOs in the manner prescribed by the Exchange and are executed within the System by Participants at multiple price levels without respect to Protected Quotations of other market centers within the meaning of Rule 600(b) of Regulation NMS under the Act. ISOs are immediately executable within the System pursuant to PHLX Rule 3307. PHLX proposes to add that ISOs are not eligible for routing as set out in new Rule 3315.<sup>5</sup>

In addition, PHLX proposes to amend Rule 3305, Order Entry Parameters, to add a paragraph on routing. The new routing paragraph will state that all System orders entered by Participants directing or permitting routing to other market centers shall be routed for potential display and/or execution as set forth in new Rule 3315. In connection with the trading of securities governed by Regulation NMS, System orders shall be routed for potential display and/or execution in compliance with Regulation NMS. This paragraph is intended to add routing to the rule that governs order types generally.

Second, PHLX proposes to adopt new Rule 3315, Order Routing, to fully spell out how routing will work and to generally track the language of NASDAQ Rule 4758. Paragraph (a) describes the order routing process and states that all routing shall be in compliance with Rule 610 of Regulation NMS under the Act. Specifically, the Exchange proposes to introduce several routing strategies, all of which operate on NASDAQ today. These are PSTG, PSKN, PSCN, PSKP, PTFY, PMOP and PCRT, which are spelled out in proposed Rule 4758(a)(1)(A)(iii)-(vii).<sup>6</sup>

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<sup>5</sup> This is the same as NASDAQ Rule 4751(f)(6).

<sup>6</sup> These correspond to the following routing strategies on NASDAQ, respectively: STGY, SKNY, SCAN, SKIP, TFTY, MOPP and CART.

PSTG is a routing option under which orders would check the PSX book, check destinations on the PSTG System routing table,<sup>7</sup> and then return to the PSX book if shares remain unexecuted. After returning to the PSX book, a PSTG order will subsequently route out to another market center if it posts a bid or offer that locks or crosses the PSTG order.<sup>8</sup> PSKN is a form of PSTG in which the entering party instructs the System to bypass any market centers included in the PSTG System routing table that are not posting Protected Quotations within the meaning of Regulation NMS.<sup>9</sup>

PSCN is a routing option under which orders check the PSX book, check destinations on the PSCN System routing table, and then return to the BX book. After returning to the PSX book, a PSCN order will not subsequently route out to another market center if it posts a bid or offer that locks or crosses the PSCN order.<sup>10</sup> PSKP is a form of PSCN in which the entering party instructs the System to bypass any market centers included in the PSCN System routing table that are not posting Protected Quotations within the meaning of Regulation NMS.<sup>11</sup>

PTFY is a routing option under which orders check the PSX book for available shares only if instructed by the entering firm prior to routing to destinations on the PTFY System routing table. Thereafter, they return to the PSX book and, like PSCN orders, do not route out again.<sup>12</sup>

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<sup>7</sup> Routing tables are explained in proposed Rule 3315(a)(1)(A).

<sup>8</sup> See proposed Rule 3315(a)(1)(A)(iii).

<sup>9</sup> See proposed Rule 3315(a)(1)(A)(iii).

<sup>10</sup> See proposed Rule 3315(a)(1)(A)(iv).

<sup>11</sup> See proposed Rule 3315(a)(1)(A)(iv).

<sup>12</sup> See proposed Rule 3315(a)(1)(A)(v).

PMOP is a routing option under which orders route only to Protected Quotes, but only for displayed size. If shares remain unexecuted after routing, they are posted to the PSX book and do not route out again.<sup>13</sup>

PCRT is a routing option that will route to NASDAQ OMX BX, check the System for available shares and then route to NASDAQ, with any unexecuted shares posting to the Exchange's book or cancelling, depending upon the time-in-force of the order. Shares posted on the Exchange's book are not routed out again.<sup>14</sup> This routing option is similar to CART on NASDAQ, which also routes among the three exchanges in the same order: BX, PSX, NASDAQ.<sup>15</sup> PCRT, like all of the proposed routing strategies is designed to comply with SEC Rule 611 and the other provisions of Regulation NMS.<sup>16</sup>

Paragraph (b) describes the routing broker, Nasdaq Execution Services LLC ("NES") and the conditions under which NES would operate. Currently, NES does not provide inbound routing to NASDAQ. At this time, PHLX proposes to use NES as its outbound routing facility for cash equities, providing outbound routing from PSX to other market centers, including their affiliates, NASDAQ and BX.<sup>17</sup>

The Exchange, NASDAQ, BX and NES are affiliates. NES is a broker-dealer and member of NASDAQ, BX and the Exchange. Accordingly, the affiliate relationship between PHLX and NES, its member, raises the issue of an exchange's affiliation with a member of such

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<sup>13</sup> See proposed Rule 3315(a)(1)(A)(vi).

<sup>14</sup> See proposed Rule 3315(a)(1)(A)(vii).

<sup>15</sup> See Securities Exchange Act Release No. 63900 (February 14, 2011), 76 FR 9397 (February 17, 2011) (SR-NASDAQ-2011-026).

<sup>16</sup> 17 CFR 242.611.

<sup>17</sup> In order for PHLX to provide outbound routing services, BX and NASDAQ each must file a proposed rule change to receive inbound orders from their affiliate exchange, PHLX.

exchange. Specifically, in connection with prior filings, the Commission has expressed concern that the affiliation of an exchange with one of its members raises the potential for unfair competitive advantage and potential conflicts of interest between an exchange's self-regulatory obligations and its commercial interests.<sup>18</sup>

Accordingly, in this proposed rule change, PHLX proposes to permit NES to operate as its routing broker, providing outbound routing to its affiliates, under the following conditions, which are the same as those found in NASDAQ rules:

- (1) NES shall route orders to other market centers as directed by PHLX;
- (2) NES will not engage in any business other than: (a) as an outbound router for PHLX and (b) any other activities it may engage in as approved by the Commission.<sup>19</sup>
- (3) NES shall operate as a facility, as defined in Section 3(a)(2) of the Act, of PHLX.
- (4) For purposes of SEC Rule 17d-1, the designated examining authority of NES shall be a self-regulatory organization unaffiliated with PHLX or any of its affiliates.
- (5) PHLX shall be responsible for filing with the Commission proposed rule changes related to the operation of, and fees for services provided by, NES and NES shall be subject to exchange non-discrimination requirements.
- (6) The books, records, premises, officers, agents, directors and employees of NES as a facility of PHLX shall be deemed to be the books, records, premises, officers, agents, directors and employees of PHLX for purposes of, and subject to oversight pursuant to,

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<sup>18</sup> See Securities Exchange Act Release Nos. 59153 (December 23, 2008), 73 FR 80485 (SR-NASDAQ-2008-098); and 62736 (August 17, 2010), 75 FR 51861 (August 23, 2010) (SR-NASDAQ-2010-100).

<sup>19</sup> Separately, BX has also filed a proposed rule change seeking approval to have NES operate as the routing broker. See SR-BX-2011-048.

the Act. The books and records of NES as a facility of PHLX shall be subject at all times to inspection and copying by the Commission.

(7) Use of NES to route orders to other market centers will be optional. Parties that do not desire to use NES must enter orders into PHLX as immediate-or-cancel orders or any other order-type available through PHLX that is ineligible for routing.

(8) NES shall establish and maintain procedures and internal controls reasonably designed to adequately restrict the flow of confidential and proprietary information between PHLX and its facilities (including NES as its routing facility) and any other entity.

These conditions are intended to address the Commission's concerns regarding potential conflicts of interest in instances where a member firm is affiliated with an exchange.

Furthermore, PHLX Rule 985(b)(1)(A) currently provides that the Exchange or any entity with which it is affiliated shall not, directly or indirectly, acquire or maintain an ownership interest in, or engage in a business venture with, an Exchange member or an affiliate of an Exchange member in the absence of an effective filing under Section 19(b) of the Exchange Act. Because NES is an Exchange member and PHLX now proposes to engage in the business venture of outbound routing using NES as its routing broker, the Exchange has filed this proposed rule change under Section 19(b) of the Act.

The Exchange also proposes to adopt Rule 3315(c) to address the recently adopted Market Access Rule.<sup>20</sup> In order to comply with Rule 15c3-5,<sup>21</sup> NES proposes to implement, as part of its procedures, certain tests, on both an order-by-order basis and over a short period of

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<sup>20</sup> See Securities Exchange Act Release No. 63241 (November 3, 2010), 75 FR 69792 (November 15, 2010).

<sup>21</sup> 17 CFR 240.15c3-5.

time, that are designed to limit the financial exposure that could arise as a result of market access and to ensure compliance with all regulatory requirements that are applicable in connection with market access. Consistent with the requirements of the Market Access Rule, these tests are designed to reject orders that NES deems to be erroneous or duplicative, would cause the entering member's credit exposure to exceed a preset credit threshold, or are noncompliant with pre-trade regulatory requirements (as defined in the Market Access Rule). To the extent NES determines, based on these procedures, that an order should be rejected, NES may also seek to cancel orders that have already been routed away.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,<sup>22</sup> in general, and with Sections 6(b)(5) of the Act,<sup>23</sup> in particular, in that the proposal is 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, because PSX will be better able to serve its customers and compete with other markets by offering optional routing services. The Exchange believes that these services are useful to its participants seeking efficient access to the best markets, consistent with removing impediments to and perfecting the mechanism of a free and open market and a national market system. The Exchange also believes that its rules applicable to the routing broker should promote just and equitable principles of trade and prevent fraudulent and manipulative acts and practices by

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<sup>22</sup> 15 U.S.C. 78f.

<sup>23</sup> 15 U.S.C. 78f(b)(5).



establishing conditions that are intended to address potential conflicts of interest between the Exchange and its affiliated member, consistent with the framework in place at other exchanges using an affiliated routing broker.

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.

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate, it has become effective pursuant to 19(b)(3)(A) of the Act<sup>24</sup> and Rule 19b-4(f)(6)<sup>25</sup> thereunder.

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the

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<sup>24</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>25</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

Commission shall institute proceedings to determine whether the proposed rule should be approved or 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-2011-108 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-2011-108. 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-2011-108 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>26</sup>

Elizabeth M. Murphy  
Secretary

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<sup>26</sup> 17 CFR 200.30-3(a)(12).