

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-69118; File No. SR-Phlx-2013-20)

March 12, 2013

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Adopt New Exchange Rule 1047(f) and (g) for Limit Up/Limit Down Situations

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> notice is hereby given that on February 28, 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 proposes to: (i) adopt new Exchange Rule 1047(f) to provide for how the Exchange proposes to treat orders in response to the Regulation NMS Plan to Address Extraordinary Market Volatility; and (ii) adopt new Exchange Rule 1047(g) to codify that the Exchange shall halt trading in all options overlying NMS stocks when the equities markets initiate a market-wide trading halt due to extraordinary market volatility.

The text of the proposed rule change is below; proposed new language is underlined.

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**Rule 1047. Trading Rotations, Halts and Suspensions**

(a) – (e) No change.

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

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

(f) This paragraph shall be in effect during a pilot period to coincide with the pilot period for the Plan to Address Extraordinary Market Volatility Pursuant to Rule 608 of Regulation NMS, as it may be amended from time to time (“LULD Plan”). Capitalized terms used in this paragraph shall have the same meaning as provided for in the LULD Plan. During a Limit State and Straddle State in the Underlying NMS stock:

(i) The Exchange will not open an affected option.

(ii) After the opening, the Exchange shall reject Market Orders, as defined in Rule 1066(a) (including Complex Orders, as defined in Rule 1080.08), and shall notify Participants of the reason for such rejection. The Exchange shall cancel Complex Orders that are Market Orders residing in the Phlx XL System if they are about to be executed by the Phlx XL System.

(iii) After the opening, the Exchange shall elect Stop Orders, as defined in Rule 1066(c)(1), and, because they become Market Orders, shall cancel them back and notify Participants of the reason for such rejection.

(g) The Exchange shall halt trading in all options whenever the equities markets initiate a market-wide trading halt commonly known as a circuit breaker in response to extraordinary market conditions.

**••• Commentary:**

**.01 - .03** 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 Exchange proposes: (i) to adopt Exchange Rule 1047(f) to provide for how the Exchange will treat orders in response to the Regulation NMS Plan to Address Extraordinary Market Volatility (the “Plan”), which is applicable to all NMS stocks, as defined in Regulation NMS Rule 600(b)(47); and (ii) to adopt Exchange Rule 1047(g) to codify that the Exchange shall halt trading in all options when the equities markets initiate a market-wide trading halt due to extraordinary market volatility. The Exchange proposes to adopt new Rule 1047(f) for a pilot period that coincides with the pilot period for the Plan.

Background

Since May 6, 2010, when the markets experienced excessive volatility in an abbreviated time period, i.e., the “flash crash,” the equities exchanges and the Financial Industry Regulatory Authority (“FINRA”) have implemented market-wide measures designed to restore investor confidence by reducing the potential for excessive market volatility. The measures adopted include pilot plans for stock-by-stock trading pauses,<sup>3</sup> related changes to the equities market clearly erroneous execution rules,<sup>4</sup> and more stringent equities market maker quoting requirements.<sup>5</sup> On May 31, 2012, the Commission approved the Plan, as amended, on a one-year

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<sup>3</sup> See e.g., Exchange Rule 3100.

<sup>4</sup> See e.g., Exchange Rule 3312.

<sup>5</sup> See e.g., NASDAQ Rule 4613.

pilot basis.<sup>6</sup> In addition, the Commission approved changes to the equities market-wide circuit breaker rules on a pilot basis to coincide with the pilot period for the Plan.<sup>7</sup>

The Plan is designed to prevent trades in individual NMS stocks from occurring outside of specified Price Bands.<sup>8</sup> As described more fully below, the requirements of the Plan are coupled with Trading Pauses to accommodate more fundamental price moves (as opposed to erroneous trades or momentary gaps in liquidity). All trading centers in NMS stocks, including both those operated by Participants and those operated by members of Participants, are required to establish, maintain, and enforce written policies and procedures that are reasonably designed to comply with the requirements specified in the Plan.

As set forth in more detail in the Plan, Price Bands consisting of a Lower Price Band and an Upper Price Band for each NMS Stock are calculated by the Processors.<sup>9</sup> When the National Best Bid (Offer) is below (above) the Lower (Upper) Price Band, the Processors shall disseminate such National Best Bid (Offer) with an appropriate flag identifying it as unexecutable. When the National Best Bid (Offer) is equal to the Upper (Lower) Price Band, the Processors shall distribute such National Best Bid (Offer) with an appropriate flag identifying it as a Limit State Quotation.<sup>10</sup> All trading centers in NMS stocks must maintain written policies

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<sup>6</sup> See Securities Exchange Act Release No. 67091 (May 31, 2012), 77 FR 33498 (June 6, 2012) (File No. 4-631) (Order Approving the Plan on a Pilot Basis).

<sup>7</sup> See Securities Exchange Act Release No. 67090 (May 31, 2012), 77 FR 33531 (June 6, 2012) (SR-BATS-2011-038; SR-BYX-2011-025; SR-BX-2011-068; SR-CBOE-2011-087; SR-C2-2011-024; SR-CHX-2011-30; SR-EDGA-2011-31; SR-EDGX-2011-30; SR-FINRA-2011-054; SR-ISE-2011-61; SR-NASDAQ-2011-131; SR-NSX-2011-11; SR-NYSE-2011-48; SR-NYSEAmex-2011-73; SR-NYSEArca-2011-68; SR-Phlx-2011-129).

<sup>8</sup> Unless otherwise specified, capitalized terms used in this rule filing are based on the defined terms of the Plan.

<sup>9</sup> See Section V(A) of the Plan.

<sup>10</sup> See Section VI(A) of the Plan.

and procedures that are reasonably designed to prevent the display of offers below the Lower Price Band and bids above the Upper Price Band for NMS stocks. Notwithstanding this requirement, the Processor shall display an offer below the Lower Price Band or a bid above the Upper Price Band, but with a flag that it is non-executable. Such bids or offers shall not be included in the National Best Bid or National Best Offer calculations.<sup>11</sup> Trading in an NMS stock immediately enters a Limit State if the National Best Offer (Bid) equals but does not cross the Lower (Upper) Price Band.<sup>12</sup> Trading for an NMS stock exits a Limit State if, within 15 seconds of entering the Limit State, all Limit State Quotations were executed or canceled in their entirety. If the market does not exit a Limit State within 15 seconds, then the Primary Listing Exchange would declare a five-minute trading pause pursuant to Section VII of the Plan, which would be applicable to all markets trading the security.<sup>13</sup> In addition, the Plan defines a Straddle State as when the National Best Bid (Offer) is below (above) the Lower (Upper) Price Band and the NMS stock is not in a Limit State. For example, assume the Lower Price Band for an NMS Stock is \$9.50 and the Upper Price Band is \$10.50, such NMS stock would be in a Straddle State if the National Best Bid were below \$9.50, and therefore unexecutable, and the National Best Offer were above \$9.50 (including a National Best Offer that could be above \$10.50). If an NMS stock is in a Straddle State and trading in that stock deviates from normal trading characteristics, the Primary Listing Exchange may declare a trading pause for that NMS stock if such Trading Pause would support the Plan's goal to address extraordinary market volatility.

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<sup>11</sup> See Section VI(A)(3) of the Plan.

<sup>12</sup> See Section VI(B)(1) of the Plan.

<sup>13</sup> The primary listing market would declare a Trading Pause in an NMS stock; upon notification by the primary listing market, the Processor would disseminate this information to the public. No trades in that NMS stock could occur during the trading pause, but all bids and offers may be displayed. See Section VII(A) of the Plan.

## Proposed Rule 1047(f)

### Openings

The Exchange proposes to adopt new Exchange Rule 1047(f) to provide for how the Exchange shall treat orders and quotes in options overlying NMS stocks when the Plan is in effect. First, the Exchange proposes to adopt new subparagraph (i) to provide for how the Exchange shall treat the opening rotation. The opening in an option will not commence in the event that the underlying NMS stock is open, but has entered into a Limit State or Straddle State. If this occurs, the opening will only commence and complete if the underlying NMS stock stays out of a Limit or Straddle State. Accordingly, new Rule 1047(f)(i) will provide that the Exchange will not open an affected option. As a result, if an opening process is occurring, it will cease and then start the opening process from the beginning once the Limit State or Straddle State is no longer occurring. If a Limit State or Straddle State occurs after an option opens, but during a Complex Order Strategy opening, the Complex Order Strategy opening will continue as long as the option remains open. This is consistent with the provisions of Rule 1047 that state that the Exchange will halt an option when the underlying security is subject to a regulatory halt.

### Orders

Second, the Exchange proposes to adopt provisions regarding the treatment of certain orders if the underlying NMS stock is in a Limit State or Straddle State. Whenever an NMS stock is in a Limit State or Straddle State, trading continues; however, there will not be a reliable price for a security to serve as a benchmark for the price of the option. For example, if the underlying NMS stock is in a Limit State, while trading in that stock continues, by being in a Limit State, there will be either cancellations or executions at that price, and if the Limit State is not resolved in 15 seconds, the NMS Stock will enter a Trading Pause. If an NMS stock is in a

Straddle State, that means that there is either a National Best Bid or National Best Offer that is non-executable, which could result in limited price discovery in the underlying NMS stock. In addition to the lack of a reliable underlying reference price, the Exchange is concerned about the width of the markets and quality of the execution for market participants during a Limit State or Straddle State. While the Exchange recognizes the importance of continued trading in options overlying NMS stocks during Limit States and Straddle States, the Exchange believes that certain types of orders increase the risk of errors and poor executions and therefore should not be allowed during these times when there may not be a reliable underlying reference price, there may be a wide bid/ask quotation differential, and there may be lower trading liquidity in the options markets.

Therefore, the Exchange proposes that if an NMS stock is in a Limit State or Straddle State, once the option has opened for trading, the Exchange shall reject all incoming Market Orders, as defined in Rule 1066(a) (including Complex Orders, as defined in Rule 1080.08), and shall notify Participants of the reason for such rejection.<sup>14</sup> Market orders residing in the Phlx XL System will be handled in the normal fashion under Exchange rules. The Exchange shall also cancel Complex Orders that are Market Orders residing in the Phlx XL System if they are about to be executed by the Phlx XL System.<sup>15</sup> In addition, the Phlx XL System will elect Stop Orders<sup>16</sup> if the underlying NMS stock is in a Straddle State or a Limit State, but, because they

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<sup>14</sup> Such orders will not be eligible for order re-entry pursuant to Rule 1082, and market orders being re-entered pursuant to this provision will be rejected as well.

<sup>15</sup> Pursuant to Rule 1080.08, Complex Orders can become executable after a COLA and during the COLA Timer.

<sup>16</sup> See Rule 1066(c)(1). Stop Orders when elected create a Market Order to buy or sell the option. In contrast, the Exchange is not proposing to prohibit the election of Stop Limit Orders. Stop Limit Orders when elected create a Limit Order to buy or sell the option at a specific price. See Rule 1066(c)(1). The Exchange believes that Stop Limit Orders do not raise the same risks during periods of extraordinary volatility, because, once elected, the

become Market Orders, shall cancel them back and notify Participants of the reason for such rejection. The Exchange believes that permitting these order types to execute when the underlying NMS stock is in a Limit State or Straddle State would add to the volatility in the options markets during times of extraordinary market volatility and could have the potential to lead to unwanted executions. The Exchange believes that adding certainty to the treatment of Market Orders and Stop Orders when the underlying NMS stock is in these situations should encourage market participants to continue to provide liquidity to the Exchange and thus promote a fair and orderly market.

#### Proposed Rule 1047(g)

The Exchange also proposes to adopt Rule 1047(g), which provides that the Exchange shall halt trading in all options whenever the equities markets initiate a market-wide trading halt commonly known as a circuit breaker in response to extraordinary market conditions. Although the Exchange's rules currently address a variety of situations involving halts, pauses and suspensions,<sup>17</sup> the Exchange has determined to adopt a very specific rule to deal with circuit breaker-related halts. The Exchange believes that this rule can be adopted on a permanent basis, even though the equities circuit breakers are subject to a pilot program, because the proposed rule refers to such circuit breakers generally.

#### 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the provisions of Section 6 of the Act,<sup>18</sup> in general, and with Section 6(b)(5) of the Act,<sup>19</sup> in particular, which

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associated limit orders would not race through the order book in the manner that an elected Market Order would.

<sup>17</sup> For example, Rule 1047(e) addresses halting an option when trading in the underlying NMS stock is paused.

<sup>18</sup> 15 U.S.C. 78f.



requires that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, protect investors and the public interest, because it should provide certainty about how options orders and trades will be handled during periods of extraordinary volatility in the underlying security. Specifically, under the proposal, market participants will be able to continue to trade options overlying securities that are in a Limit State or Straddle State, while addressing specific order types that are subject to added risks during such periods. The Exchange believes that the rejection of options Market Orders (including elected Stop Orders) should help to prevent executions that might occur at prices that have not been reliably formed, which should, in turn, protect, in particular, retail investors from executions of un-priced orders during times of significant volatility.

Accordingly, the Exchange believes that the proposed rule change is consistent with these requirements in that it should reduce the negative impacts of sudden, unanticipated volatility in individual options, and serve to preserve an orderly market in a transparent and uniform manner, enhance the price-discovery process, increase overall market confidence, and promote fair and orderly markets and the protection of investors.

**B. Self-Regulatory Organization's Statement on Burden on Competition**

The Exchange does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended. Specifically, the proposal does not impose an intra-market burden on competition,

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<sup>19</sup> 15 U.S.C. 78f(b)(5).

because it will apply to all Options Participants. Nor will the proposal impose a burden on competition among the options exchanges, because, in addition to the vigorous competition for order flow among the options exchanges, the proposal addresses a regulatory situation common to all options exchanges. To the extent that market participants disagree with the particular approach taken by the Exchange herein, market participants can easily and readily direct order flow to competing venues. The Exchange believes this proposal for how to treat options openings and orders will not impose a burden on competition and will help provide certainty during periods of extraordinary volatility in an NMS stock.

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

Written comments were neither solicited nor received.

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

The Exchange has filed the proposed rule change pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>20</sup> and Rule 19b-4(f)(6) thereunder.<sup>21</sup> Because the 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 prior to 30 days from the date on which it was filed, or such shorter time as the Commission may designate, if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6)(iii) thereunder.

At any time within 60 days of the filing of such proposed rule change, the Commission

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<sup>20</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>21</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires the Exchange to give the Commission written notice of the Exchange's intent to file the proposed rule change, along with a brief description and text of 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.

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 Commission shall institute proceedings under Section 19(b)(2)(B) of the Act<sup>22</sup> to determine whether the proposed rule change 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 No. SR-Phlx-2013-20 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 No. SR-Phlx-2013-20. 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

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<sup>22</sup> 15 U.S.C. 78s(b)(2)(B).

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 No. SR-Phlx-2013-20 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>23</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>23</sup> 17 CFR 200.30-3(a)(12).