

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-71731; File No. SR-Phlx-2014-16)

March 18, 2014

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Provide that Market Maker Complex Orders Cannot Initiate a Complex Order Live Auction

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 March 12, 2014, NASDAQ OMX PHLX LLC (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“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 provide that market maker Complex Orders cannot initiate a Complex Order Live Auction.

The text of the proposed rule change is below; proposed new language is underlined; proposed deletions are in brackets.

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Rule 1080. Phlx XL and Phlx XL II

(a) – (p) No change.

••• *Commentary:* -----

.01- .07 No change.

.08 Complex Orders on Phlx XL.

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

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

(a) – (d) No change.

(e) Process for Complex Order Live Auction ("COLA"). Complex Orders on the Complex Order Book ("CBOOK," as defined below) may be subject to an automated auction process.

(i) For purposes of paragraph (e):

(A) No change.

(B) (1) A "COLA-eligible order" means a Complex Order (a) identified by way of a COOP, or (b) that, upon receipt, improves the cPBBO respecting the specific Complex Order Strategy that is the subject of the Complex Order and is not for a market maker, as specified in Rule 1080.08 (b)(ii). If the Phlx XL system identifies the existence of a COLA-eligible order following a COOP or by way of receipt during normal trading of a Complex Order that improves the cPBBO, such COLA-eligible order will initiate a COLA, during which Phlx XL participants may bid and offer against the COLA-eligible order pursuant to this rule. COLA-eligible orders will be executed without consideration of any prices that might be available on other exchanges trading the same options contracts.

(2) No change.

(ii) - (ix) No change.

(f) – (i) 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 Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of the proposal is to correct the rule text to provide that market maker Complex Orders cannot trigger a COLA. The Exchange's Complex Order System is governed by Rule 1080.08 and provides that COLA-eligible orders will trigger a COLA.<sup>3</sup> The COLA is an automated auction that is intended to seek additional liquidity and price improvement for Complex Orders. Rule 1080.08(e) provides that a COLA-eligible order means a Complex Order identified by way of a COOP, or that, upon receipt, improves the cPBBO respecting the specific Complex Order Strategy that is the subject of the Complex Order.

However, Phlx's system is programmed such that market maker<sup>4</sup> orders do not trigger a COLA, regardless of whether such orders are IOC or DAY orders.<sup>5</sup> Rather than triggering a COLA, market maker Complex Orders are handled pursuant to Rule 1080.08(c)(i), which provides that Complex Orders may be executed against the Complex Order Book or placed on the Complex Order Book.<sup>6</sup> Pursuant to Rule 1080.08(e), market makers can interact with a COLA-eligible order by submitting responsive interest during the COLA. Furthermore, Rule

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<sup>3</sup> Rule 1080.08(e)(i)(B)(1).

<sup>4</sup> Market makers include SQTs, RSQTs, non-SQT ROTs, specialists and non-Phlx market makers on another exchange. See Rules 1014 and 1080.08(b)(ii).

<sup>5</sup> The Exchange began permitting market maker orders to be entered as DAY orders recently. See Securities Exchange Act Release No. 63777 (January 26, 2011), 76 FR 5630 (February 1, 2011) (SR-Phlx-2010-157). Previously, they could only be entered as IOC orders and did not trigger a COLA.

<sup>6</sup> Rule 1080.08(c)(iii)(D) provides that paragraph (c) applies to all Complex Order executions, whether executed in a COLA or not.

1080.08(f) governs how Complex Orders are placed on the CBOOK and how they are executed.

The Exchange is amending Rule 1080.08(e)(i)(B)(1) to correct its rule text to state that market maker orders are not “COLA-eligible” such that they cannot trigger a COLA. The Exchange believes that it is appropriate for market maker Complex Orders not to trigger a COLA, because it results in a delay, during which markets can change and other orders can trade. The Exchange does not believe that this will disadvantage market makers and may in fact be more consistent with their trading goals and style. Specifically, market makers provide liquidity, making markets and submitting bids/offers/orders based on current market conditions, which can, of course, change rapidly; market makers are therefore concerned about the risks associated with the time delay of an auction more so than the potential benefit of price improvement for any one particular order. Moreover, market makers generally view auctions in terms of participating as responders. The Exchange notes that market makers have not expressed concern or dissatisfaction about their Complex Orders not triggering a COLA.

If the Exchange’s system had provided that market maker orders could trigger a COLA, market makers could nevertheless enter their orders as DNA orders<sup>7</sup> to avoid a COLA, but DNA orders are cancelled if not immediately executed. Thus, DNA orders do not provide the opportunity for market makers to send an order that can both execute without delay and result in the remainder posting on the CBOOK.

The Exchange notes that it is common for certain functionality not to be available to all origin types. For example, as noted above, Complex Orders with certain time-in-force instructions are available only to certain origin types; today, market makers cannot enter Good-

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<sup>7</sup> See Rule 1080.08(a)(viii).

Til-Cancelled Complex Orders.<sup>8</sup> In addition, other options exchanges have the flexibility in their rules to determine which participants can initiate a complex order auction and these exchanges can make this determination on a class-by-class basis.<sup>9</sup> The Exchange believes that this is functionally equivalent to its proposal, because: (i) implementation by class (puts versus calls) is merely an operational detail; (ii) the Exchange does not believe that there is any particular reason to differentiate among different classes; and (iii) the Exchange believes that CBOE, as a practical matter, implements this provision across all options and not class-by-class.<sup>10</sup>

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the provisions of Section 6 of the Act,<sup>11</sup> in general, and with Section 6(b)(5) of the Act,<sup>12</sup> in particular, which requires that the rules of an exchange be designed to promote just and equitable principles of trade, and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers. Specifically, the Exchange believes that the proposal is designed to promote just and equitable principles of trade, because it affords to market makers an immediate execution over the benefits of an auction. As discussed above, in their role as liquidity providers, market

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<sup>8</sup> See Rule 1080.08(b)(ii).

<sup>9</sup> See CBOE Rule 6.53C(d)(i)(2), NYSE Arca Rule 6.91(c)(1) and NYSE MKT Rule 980NY(e)(1).

<sup>10</sup> See e.g., Regulatory Circular RG12-088 dated June 29, 2012 at <http://cchwallstreet.com/CBOETools/PlatformViewer.asp?searched=1&selectednode=chp%5F1%5F26&CiRestriction=COA%2Deligible&manual=%2Fcboe%2Fbulletins%2Fcb oe%2Dreg%2Dbull%2D2012%2F> and CBOE Regulatory Circular RG13-012 dated January 18, 2013 at <http://cchwallstreet.com/CBOETools/PlatformViewer.asp?searched=1&selectednode=chp%5F1%5F49&CiRestriction=COA%2Deligible&manual=%2Fcboe%2Fbulletins%2Fcb oe%2Dreg%2Dbull%2D2013%2F>. These CBOE Regulatory Circulars do not differentiate among option classes respecting CBOE's COA.

<sup>11</sup> 15 U.S.C. 78f.

<sup>12</sup> 15 U.S.C. 78f(b)(5).

makers generally prefer an immediate execution when entering an order, due to the potential market risk. In the complex orders marketplace, market makers generally respond to auctions rather than enter orders. Accordingly, from their particular perspective, avoiding an auction in the case where they do enter an order is consistent with just and equitable principles of trade because it helps them manage their trading and therefore their risk.

The Exchange does not believe that the proposal is unfairly discriminatory, because, although market makers are being treated differently than other participants, the Exchange believes that market makers would themselves not regard this proposal negatively, because they do not necessarily find that a COLA is necessary or helpful. In addition, it is not unfairly discriminatory, because market makers, unlike other participants, generally only respond to auctions and prefer immediate execution, such that treating them differently than other participants is rooted in the way they trade and the way they function, to their benefit, rather than in an effort to exclude them or be unfair to them. Other options exchanges have the ability under their rules not to trigger an auction by participant type, such that the Commission has approved the ability to treat different participants differently respecting complex order auctions.

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, because, even though it would result in market maker orders not triggering a COLA, the ability of market makers to compete amongst each other and with other market participants would not be diminished. Whether or not market makers orders trigger a COLA has no bearing on how they compete with each other in the marketplace; market makers compete based on price and

trading strategy as applied to particular market conditions, regardless of auctions. With respect to competition with other market participants, even if their orders do not trigger a COLA, market makers can continue to compete by responding to auctions triggered by other participant types.

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 could result in the same outcome on three other exchanges that have the flexibility to determine which complex orders trigger an auction. To the extent that market makers disagree with the particular approach taken by the Exchange herein, market makers can easily and readily direct complex order flow to competing venues.

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 from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act<sup>13</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>14</sup>

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

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<sup>13</sup> 15 U.S.C. 78s(b)(3)(a)(ii).

<sup>14</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.

action is: (i) necessary or appropriate in the public interest; (ii) for the protection of investors; or (iii) otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the 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-2014-16 on the subject line.

##### Paper comments:

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

All submissions should refer to File Number SR-Phlx-2014-16. 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 the 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-2014-16 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>15</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>15</sup> 17 CFR 200.30-3(a)(12).