

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72152; File No. SR-Phlx-2014-32)

May 12, 2014

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Regarding the Limitation on Entering Electronic Limit Orders From Off the Floor of the Exchange

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹, and Rule 19b-4² thereunder, notice is hereby given that on May 2, 2014, 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 the Substance of the Proposed Rule Change

The Exchange is filing with the Commission a proposal to amend Phlx Rule 1080 (Phlx XL and Phlx XL II) to change the limitation on Exchange members entering, or facilitating entry of, electronic limit orders in the same option series from off the floor of the Exchange, so that the limitation does not apply to off floor broker dealers or Professionals as defined in Rule 1000(b)(14).³

The text of the proposed rule change is available on the Exchange’s website at <http://nasdaqomxphlx.cchwallstreet.com>, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ As discussed in the proposal, the limitation will continue to apply to Professional all-or-none orders.

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 amend Phlx Rule 1080(j) to change the limitation on Exchange members entering, or facilitating entry of, electronic limit orders in the same option series from off the floor of the Exchange (known as “limitation” or “limitation on orders”), so that the limitation does not apply to off floor broker dealers or Professionals as defined in Rule 1000(b)(14).⁴

This proposal will align the Exchange with other options markets that do not limit the entry of off floor broker dealer and Professional limit orders, and effectively acting as market makers.⁵

There are, along with specialists, several types of Registered Option Traders (“ROTs”) on

⁴ Per Rule 1000(b)(14), the term “Professional” means any person or entity that (i) is not a broker or dealer in securities, and (ii) places more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s).

⁵ See subsection (b) of International Securities Exchange (“ISE”) Rule 717 (Limitations on Orders). As discussed, while the language of the ISE Rule 717 and Exchange Rule 1080(j) is different, as a result of this filing the practical effect of the rules will be similar.

the Exchange. These include market makers that are Streaming Quote Traders (“SQTs”),⁶ Directed Streaming Quote Traders (“DSQTs”), Remote Streaming Quote Traders (“RSQTs”)⁷ and Directed Remote Streaming Quote Traders (“DRSQTs”).⁸ Specialists may function on the floor of the Exchange as well as off floor (“Remote Specialists”).⁹

Current Phlx Rule 1080 developed from a decades-old pilot program to operate the Exchange’s Automated Options market (“AUTOM”) system to allow electronic delivery of options orders from member firms directly to the appropriate specialist on the Exchange options trading floor (with electronic confirmation of order executions).¹⁰ The AUTOM order delivery

⁶ An SQT is an ROT who has received permission from the Exchange to generate and submit option quotations electronically in eligible options to which such SQT is assigned. An SQT may only submit such quotations while such SQT is physically present on the floor of the Exchange. See Phlx Rule 1014(b)(ii)(A).

⁷ An RSQT is an ROT that is a member or member organization with no physical trading floor presence who has received permission from the Exchange to generate and submit option quotations electronically in eligible options to which such RSQT has been assigned. An RSQT may only submit such quotations electronically from off the floor of the Exchange. See Phlx Rule 1014(b)(ii)(B). As many as three RSQTs may be affiliated with an RSQT Organization.

⁸ A DSQT is an SQT and a DRSQT is an RSQT that receives a Directed Order. Exchange Phlx Rule 1080(l)(i)(A) defines Directed Order as any customer order (other than a stop or stop-limit order as defined in Phlx Rule 1066) to buy or sell which has been directed to a particular specialist, RSQT, or SQT by an Order Flow Provider and delivered to the Exchange via its electronic quoting, execution and trading system.

⁹ A Remote Specialist is an options specialist in one or more classes that does not have a physical presence on an Exchange floor and is approved by the Exchange pursuant to Phlx Rule 501. Phlx Rule 1020.

¹⁰ See Securities Exchange Act Release No. 25540, 53 FR 11390 (April 6, 1988)(SR-Phlx-88-10)(order granting approval of pilot program establishing AUTOM). See also Phlx Rule 1080(a) discussing AUTOM: (a) AUTOM is the Exchange's electronic order delivery and reporting system, which provides for the automatic entry and routing of Exchange-listed equity options, index options and U.S. dollar-settled foreign currency options orders to the Exchange trading floor. Orders delivered through AUTOM may be executed manually, or certain orders are eligible for AUTOM's automatic execution feature, AUTO-X, in accordance with the provisions of this Rule. Equity option, index option and U.S. dollar-settled foreign currency option specialists are required by the Exchange to participate in AUTOM and its features and enhancements. Option orders

system grew over the years into the current fully automated Phlx options trading system XL II¹¹ that is codified in Phlx Rule 1080. In addition to XL II, Phlx Rule 1080 deals with, among other things, eligibility and processing of electronic orders, how PIXL works, complex PIXL orders,¹² qualified contingent cross orders,¹³ and acceptable trade range.¹⁴

Subsection (j) of Phlx Rule 1080 sets forth the limitation on orders. Subsection (j) states that members¹⁵ shall not enter, or facilitate entry into AUTOM, as principal or agent, limit orders in the same options series from off the floor of the Exchange, for the account or accounts of the same or related beneficial owners, in such a manner that the off-floor member or the beneficial owner(s) effectively is operating as a market maker by holding itself out as willing to buy and sell such options contract on a regular or continuous basis.¹⁶ The current restriction on all limit orders is no longer needed or advisable.

entered by Exchange member organizations into AUTOM are routed to the appropriate specialist unit on the Exchange trading floor. AUTOM and AUTO-X were replaced by the Phlx XL System, such that references to both terms refer to Phlx XL.

¹¹ See Securities Exchange Act Release No. 50100 (July 27, 2004), 69 FR 46612 (August 3, 2004)(SR-Phlx-2003-59)(order granting approval of the Exchange's new electronic trading system Phlx XL, now known as XL II). The electronic trading system has continued being enhanced. See, e.g., Securities Exchange Act Release Nos. 63027 (October 1, 2010), 75 FR 62160 (October 7, 2010)(SR-Phlx-2010-108)(order granting approval of Price Improvement XL, PIXL); and 69845 (June 25, 2013), 78 FR 39429 (July 1, 2013)(SR-Phlx-2013-46)(order granting approval of Complex Order PIXL).

¹² Phlx Rule 1080(n). This section allows six-legged complex orders into PIXL.

¹³ Phlx Rule 1080(o).

¹⁴ Phlx Rule 1080(p).

¹⁵ Phlx Rule 900.2 indicates how potential members may seek admission to the Exchange.

¹⁶ In determining whether an off-floor member or beneficial owner effectively is operating as a market maker, the Exchange will consider, among other things: the simultaneous or near-simultaneous entry of limit orders to buy and sell the same options contract; the multiple acquisition and liquidation of positions in the same options series during the same day; and the entry of multiple limit orders at different prices in the same options series. Phlx Rule 1080(j).

The Exchange proposes to change the limitation in subsection (j) of Phlx Rule 1080 so that it is not applicable to off floor broker dealer limit orders or Professional limit orders (except Professional all-or-none orders). Specifically, the Exchange proposes at the end of subsection (j) to state that the limitation set forth in this rule 1080(j) does not apply to the accounts of off floor broker dealers or Professionals as the term is defined in Rule 1000(b)(14). Notwithstanding the foregoing, the limitation set forth in Rule 1080(j) will continue to apply to all-or-none orders submitted by Professionals to the Exchange.¹⁷ This is because Professionals are treated in the same manner as off-floor broker dealers for purposes of priority, but would have priority akin to customers in terms of all-or none order submitted to the Exchange.¹⁸ Moreover, non-Professional, non-broker-dealer customer orders have priority over Professional orders.¹⁹ The proposed language change would make the Exchange limitation similar to that found on another options market, namely ISE.

Subsection (j) of Phlx Rule 1080, as amended, is substantially similar in its practical effect to ISE Rule 717, which disallows entry of Priority Customer²⁰ limit orders in the same

¹⁷ Post filing, in addition to Professional all-or-none orders submitted to the Exchange, the limitation would continue to apply to non-Professional customer orders. The Exchange defines customer per Rule 1083(f) as an individual or organization that is not a broker dealer; non-Professional customer refers to an individual or organization that is neither a Professional nor a broker dealer.

¹⁸ See, e.g., Rule 1014(g).

¹⁹ Rule 1014(g)(vii).

²⁰ Unlike ISE, the Exchange does not currently have a separate category called Priority Customer. However, as discussed, after this filing the practical effect of the ISE and Exchange rules will be similar. As proposed herein the limitation would not be applicable to broker dealer orders and Professional Orders, similarly to ISE. See Securities Exchange Act Release No. 63017 (September 29, 2010), 75 FR 61795 (October 6, 2010)(SR-ISE-2010-95)(ISE does not believe necessary to impose ISE Rule 717 limitations on Priority Orders, which exclude broker dealers, and Voluntary Professionals because they are not subject to priority that is any better than market makers). In note 7 of its filing, ISE noted that the Commission has previously found that

options series. In a similar manner, the Exchange proposal in subsection (j) disallows entry of limit orders in the same options series from off the floor of the Exchange, except for off floor broker dealers and Professionals. As such, the proposal is pro-competitive because it would allow entry of orders on the Exchange similar to those that are allowed on other markets.

Changing the limitation to exclude off floor broker dealers and Professionals, being competitive in nature, is beneficial for market participants and investors.

Moreover, the current limitation for all limit orders is no longer needed or desirable. The limitation was added more than a dozen years ago²¹ when Exchange options trading was rooted in the on-floor auction model with a traditional open outcry trading floor. When the limitation was added for all limit orders, electronic market makers such as Remote Specialists, SQTs, and RSQTs (together known as “electronic market makers”) did not exist;²² the options trading floor was principally populated by on-floor trading crowds. At the time of the limitation filing, when rules and processes for electronic market makers were not yet fully established, there was a concern that certain off-floor traders had the ability to engage in simultaneous or near-simultaneous entry of limit orders, thereby effectively functioning as market makers from off the

it is consistent with the Act for an options exchange not to prohibit a user of its market from effectively operating as a market maker by holding itself out as willing to buy and sell options contracts on a regular or continuous basis without registering as a market maker. See Securities Exchange Act Release No. 57478 (March 12, 2008), 73 FR 14521 (March 18, 2008)(SR-NASDAQ-2007-004).

²¹ See Securities Exchange Act Release No. 43939 (February 7, 2001), 66 FR 10547 (February 15, 2001)(SR-Phlx-2001-05)(notice of filing and immediate effectiveness adopting Phlx Rule 1080(j))(the “limitation filing”).

²² Electronic market makers including RSQTs and Remote Specialists were introduced, and became prevalent, in the last eight years. See Securities Exchange Act Release Nos. 51126 (February 2, 2005), 70 FR 6915 (February 9, 2005)(SR-Phlx-2004-90)(approval order relating to establishment of RSQTs); and 63717 (January 14, 2011), 76 FR 4141 (January 24, 2011)(SR-Phlx-2010-145)(approval order relating to establishment of options Remote Specialists).

floor of the Exchange.²³ Over the last eight years, however, the traditional open outcry trading floor on the Exchange has evolved into a robust, predominantly electronic trading environment, with significantly fewer on-floor traders than off-floor traders and electronic market makers working through the Exchange's electronic trading system, XL II. As such, although the limitation was developed for a traditional trading floor that was only beginning to introduce electronic trading, the limitation on all limit orders from off the floor no longer makes sense in the current well-developed, predominantly electronic trading environment on the Exchange, where electronic market makers (and electronic market making including from off the floor) are no longer the exception but rather the norm.

The Exchange is also proposing to change the word "AUTOM" to "Phlx XL" to conform subsection (j) of Phlx Rule 1080 to the language of Rule 1080.²⁴ Because AUTOM does not exist anymore, this change is done for purposes of clarity and to minimize potential confusion.

The Exchange notes that changing the limitation as proposed would ensure that the current limitation against all members and market participants entering limit orders into Phlx XL in the same options series from off the floor of the Exchange, does not apply to off floor broker dealers or Professionals. This makes sense in the current highly-developed electronic trading environment that operates alongside the traditional on-floor trading system.²⁵ Off-floor electronic market makers, including those that are broker dealers or Professionals, are now a known and time-tested component of the Exchange that adds significant liquidity and depth to the benefit of market participants. The Exchange believes that changing the limitation should

²³ See 66 FR 10547, 10548.

²⁴ See supra note 10.

²⁵ The Exchange notes that like other older options markets (e.g., Chicago Board Options Exchange), it continues to operate a hybrid trading system.

result in tighter bid ask spreads for all market participants wishing to access posted liquidity.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act²⁶ in general, and furthers the objectives of Section 6(b)(5) of the Act²⁷ 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 changing the current order limitation so that the limitation no longer applies to off floor broker dealers or Professionals.

First, although the limitation on orders was added more than a dozen years ago when Exchange options trading was rooted in the on-floor auction model with a traditional open outcry trading floor, the Exchange trading system has developed into the robust, predominantly electronic trading system where most orders, whether limit or other orders, are entered from off the floor of the Exchange. The current expansive limitation is no longer needed, and is counter-productive in its current form. Second, because broker dealer and Professional orders, which tend to increase liquidity, are not subject to priority on the Exchange that is any better than other market makers, or, for that matter, non-Professional customers (except for Professional all-or-none orders), the Exchange does not believe that it is necessary to impose the Rule 1080(j) restrictions on the entry of off floor broker dealer or Professional limit orders (except for Professional all-or-none orders). In that non-Professional customer orders are provided with certain benefits such as priority on the Exchange, see Phlx Rule 1014(g) and 1080(n)(ii)(E), the Exchange believes that the limitation applicable to non-Professional customers is counterbalanced by their priority and it is proper for the limitation to continue to apply. The

²⁶ 15 U.S.C. 78f(b).

²⁷ 15 U.S.C. 78f(b)(5).

Exchange believes that the removal of the limitation on off floor broker dealers and Professionals, while continuing to apply the limitation to all-or-none orders submitted by Professionals to the Exchange²⁸ will permit entry of orders on both sides of the market more freely, resulting in more orders on the Exchange book and therefore increase liquidity on the Exchange market, all to the benefit of investors. And third, changing the limitation is competitive vis a vis other options exchanges that have a limitation that, as proposed herein, effectively does not apply to off floor broker dealers or Professionals. By promoting competition, the proposal may also lead to tighter, more efficient markets to the benefit of market participants including public investors that engage in trading and hedging on the Exchange.

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. To the contrary, the proposal further promotes competition on the Exchange which should lead to tighter, more efficient markets to the benefit of market participants including public investors that engage in trading and hedging on the Exchange, and thereby make the Exchange a desirable market vis a vis other options exchanges.

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;

²⁸ See supra notes 18 and 19 and text regarding priority.

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) [sic] of the Act²⁹ and subparagraph (f)(6) of Rule 19b-4 thereunder.³⁰

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: (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. Please include File Number SR-Phlx-2014-32 on the subject line.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission,

²⁹ 15 U.S.C. 78s(b)(3)(a) [sic].

³⁰ 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.

100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-Phlx-2014-32. 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 offices 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-2014-32, 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.³¹

Kevin M. O'Neill
Deputy Secretary

³¹ 17 CFR 200.30-3(a)(12).