

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-74434; File No. SR-PHLX-2015-20)

March 4, 2015

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend One Aspect of the Administration of Income Generated By Payment For Order Flow Fees

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 20, 2015, 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 amend one aspect of the administration of income generated by Payment for Order Flow fees which are assessed under Section II of the Pricing Schedule which pertains to Multiply Listed Options fees.

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.

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

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

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of this filing is to streamline the Exchange's administration of its payment for order flow ("PFOF") program, by allowing the Exchange to consolidate on its books two separate pools of PFOF funds per Specialist<sup>3</sup> into one consolidated pool of PFOF funds per Specialist, as explained below. The Exchange is proposing no change in the level or manner of imposition of PFOF fees. Rather, it is simply proposing to change the manner in which income from PFOF fees is reflected on the Exchange's books for each Specialist.

The Exchange's PFOF program helps its Specialists and Directed Registered Options Traders ("Directed ROTs")<sup>4</sup> establish PFOF arrangements with an order flow provider in exchange for that order flow provider directing some or all of its order flow to that Specialist or Directed ROT. This program is funded through fees paid by Registered Options Traders ("ROTs"), Specialists and Directed ROTs and assessed on transactions resulting from customer orders (the "PFOF Fees").<sup>5</sup>

These PFOF Fees are available to be disbursed by the Exchange according to the instructions of the Specialists or Directed ROTs to order flow providers who are members or

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<sup>3</sup> A Specialist is an Exchange member who is registered as an options Specialist pursuant to Rule 1020(a).

<sup>4</sup> A Registered Option Trader is defined in Exchange Rule 1014(b) as a regular member of the Exchange located on the trading floor who has received permission from the Exchange to trade in options for his own account. See Exchange Rule 1014 (b)(i) and (ii). A "Directed ROT" is an ROT who is a Directed Participant. The term "Directed Participant" applies to transactions for the account of a Specialist or ROT resulting from a customer order that is (1) directed to it by an order flow provider, and (2) executed by it electronically on Phlx XL II.

<sup>5</sup> See Securities Exchange Act Release No. 59841 (April 29, 2009), 74 FR 21035 (May 6, 2009) (SR-Phlx-2009-38).

member organizations, who submit, as agent, customer orders to the Exchange or non-members or non-member organizations who submit, as agent, customer orders to the Exchange through a member or member organization who is acting as agent for those customer orders. Any excess PFOF funds billed but not utilized by the Specialist or Directed ROT are carried forward unless the Directed ROT or Specialist elects to have those funds rebated to the applicable ROT, Directed ROT or Specialist on a pro rata basis, reflected as a credit on the monthly invoices. At the end of each calendar quarter, the Exchange calculates the amount of excess funds from the previous quarter and subsequently rebates excess funds on a pro-rata basis to the applicable ROT, Directed ROT or Specialist who paid into that pool of funds.

The Exchange provides administrative support for the PFOF program by maintaining the funds generated by PFOF fees, keeping track of the number of qualified orders each Specialist and Directed ROT has directed to the Exchange, and making payments to order flow providers on behalf of, and at the direction of, the Specialist or Directed ROT. The Exchange collects and holds the funds generated by the PFOF fees to be disbursed according to the instructions of the Specialists or Directed ROTs to order flow providers as stated above. The PFOF fees are collected by the Exchange for use by these Specialists and Directed ROTs to attract Customer orders to the Exchange from order flow providers that accept payment as a factor in making their order routing decisions.

The Exchange currently maintains on its books individual pools of PFOF funds for each Directed ROT and Specialist participating in the PFOF program. Further, the Exchange maintains two separate pools of funds for each Specialist who elects to participate in the PFOF

program.<sup>6</sup> PFOF fees resulting from undirected orders in a Specialist's option are reflected on the Exchange's books as the Specialist's "Specialist" pool. PFOF fees resulting from orders directed to the Specialist as a Directed Specialist are maintained on the Exchange's books for the Specialist as a separate "Directed ROT" pool.<sup>7</sup> The Exchange is now proposing to consolidate each Specialist's "Specialist" pool and "Directed ROT" pool into one single pool of PFOF funds per Specialist on the Exchange's books. The Exchange believes that maintaining two separate PFOF pools for a single Specialist imposes an unnecessary administrative burden on the Exchange and the Specialist. Instead, the Exchange will establish and administer on its books only one pool per Specialist which will reflect funds resulting from all PFOF fees allocable to that Specialist, whether resulting from Directed Orders or non-Directed Orders.

The Exchange originally established the separate "Directed ROT" pool and "Specialist" pool for each Specialist for purposes of transparency when Directed ROTs were first permitted,

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<sup>6</sup> By contrast, the Exchange maintains only a single pool of PFOF funds allocated for use by each Directed ROT. The pool consists of PFOF fees attributable to Directed Orders that were directed to that ROT. The Exchange established the separate pools of funds for each Directed ROT and each Specialist that participates in the Exchange's PFOF program in 2005. See Securities Exchange Act Release No. 52568 (October 6, 2005) 70 FR 60120 (October 14, 2005) (SR-Phlx-2005-58). In that filing, the Exchange stated that separate pools of funds would be available to each Specialist unit and Directed ROT solely for those trades where the PFOF fee was assessed and would be aggregated for use by each Specialist unit and each Directed ROT to attract customer orders to the Exchange from Order Flow Providers that accept payment as a factor in making their order routing decisions. For Directed Orders, PFOF fees would be assessed on a per contract basis (when the Specialist or Directed ROT opts into the program) and would be aggregated into separate pools of funds for use by each Specialist unit or Directed ROT. For non-directed electronically-delivered orders, PFOF fees would continue to be assessed on a per contract basis and would be allocated for use by the participating Specialist.

<sup>7</sup> For purposes of assessing PFOF fees, the Exchange does not differentiate between Specialists and Specialists who receive Directed Orders. The Specialist's pool generated by PFOF fees associated with orders directed to the Specialist has long been known as the "Directed ROT" pool, which is a slight misnomer as a Specialist receiving Directed Orders is known as a Directed Specialist rather than a Directed ROT. Nevertheless, the Directed ROT pool is the pool reflecting PFOF resulting from Directed Orders; the other pool reflects PFOF resulting from non-Directed orders.

like Specialists, to opt in to the PFOF program and to use the funds generated by the fee applicable to Directed Orders to pay order flow providers, to attract orders to the Exchange.<sup>8</sup>

The inclusion of Directed ROTs in the PFOF program in addition to Specialists was a significant change at the time. Specialists who opted into PFOF would be eligible to receive a pool of funds even if orders were not directed to them – the key was that they opted in, and their standing as Specialist. On the other hand, Directed ROTs who opted into the PFOF program would be eligible to receive a PFOF pool of funds on only those orders that were directed to them.

Specialists also became eligible to receive Directed Orders. Having two separate pools for Specialists reflecting (a) PFOF fees attributable to undirected Orders (the “Specialist” pool), and (b) PFOF fees attributable to Directed Orders directed to the Specialist (the “Directed ROT” pool) provided transparency and clarity as to the source of the PFOF funds. Today, the need for transparency provided by two separate pools per Specialist is not as necessary, as Specialists receive significantly detailed PFOF marketing reports, driven by the enhanced technology and supporting automated processes that underscore the Exchange’s billing and reporting systems.

Additionally, the report accompanying payments that the Exchange makes to order flow providers on behalf of the pool-owners specifies only the Specialist from which the funds are coming. The report does not identify the type of pool that is the source of the payment. From the Exchange’s perspective, there is no benefit to maintaining the two separate types of pools on its books for each Specialist. Additionally, from an external perspective, based on the

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<sup>8</sup> See Securities Exchange Act Release No. 52568 (October 6, 2005) 70 FR 60120 (October 14, 2005) (SR-Phlx-2005-58). See also Securities Exchange Act Release Nos. 51909 (June 22, 2005), 70 FR 37484 (June 29, 2005) (SR-Phlx-2005-37, modifying the Exchange’s schedule of dues, fees, and charges to revise its equity option payment for order flow program to establish a payment for order flow program that takes into account Directed Orders) and 51984 (July 7, 2005), 70 FR 40413 (July 13, 2005) (order abrogating SR-Phlx-2005-37).

Exchange's interaction with Specialists who are pool-owners and with order-flow providers, the maintenance of separate pools of funds on the Exchange's books is no longer necessary. The single pool will be termed the PFOF pool.

Lastly, the above proposal will result in each Specialist or Directed ROT having only one PFOF pool. This will also streamline their administrative and accounting processes with regard to the information provided by the Exchange and instructions they in turn provide to the Exchange. To illustrate, assume Market Maker A<sup>9</sup> is both a Specialist and a Directed ROT. Market Maker B is a Directed ROT that has opted into the PFOF program. Today, after the Exchange collects and processes the PFOF fees, Market Maker A will receive information on their "Specialist" pool and separate information on their "Directed ROT" pool. Market Maker B receives information on their "Directed ROT" pool. After the proposal is in effect, Market Maker A will receive information on its PFOF pool and Market Maker B will receive information on its PFOF pool. The distinction between "Specialist" pools and "Directed ROT" pools will be eliminated.

## 2. Statutory Basis

Phlx believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,<sup>10</sup> in general, and with Section 6(b)(5) of the Act<sup>11</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

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<sup>9</sup> As used in this paragraph, the term "Market Maker" includes both Specialists and ROTs.

<sup>10</sup> 15 U.S.C. 78f.

<sup>11</sup> 15 U.S.C. 78f(b)(5).

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.

The proposal is designed simply to eliminate an unnecessary administrative burden on the Exchange and its members, and to result in accounting and operational efficiencies for both. All Specialists opting into the PFOF program will be treated equally under the proposal and will realize the administrative benefits of the proposal uniformly.

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. The Exchange's proposal to combine the PFOF pools will simply result in administrative efficiencies for the Exchange and its members.

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>12</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>13</sup>

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<sup>12</sup> 15 U.S.C. 78s(b)(3)(a)(ii).

<sup>13</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.

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](mailto:rule-comments@sec.gov). Please include File Number SR-PHLX-2015-20 on the subject line.

##### Paper comments:

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

All submissions should refer to File Number SR-PHLX-2015-20. 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 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-2015-20 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>14</sup>

Brent J. Fields  
Secretary

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<sup>14</sup> 17 CFR 200.30-3(a)(12).