

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-77673; File No. SR-Phlx-2016-51)

April 21, 2016

Self-Regulatory Organizations; NASDAQ PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Qualified Contingent Cross Pricing

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 April 14, 2016, NASDAQ 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 the Exchange’s Pricing Schedule at Section II, entitled “Multiply Listed Options Fees.” Specifically, the Exchange is proposing to amend the Qualified Contingent Cross (“QCC”) pricing.

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.

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

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

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

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 the Exchange's Pricing Schedule at Section II, entitled "Multiply Listed Options Fees." Specifically, the Exchange is proposing to amend QCC pricing.

QCC Transaction Fee

Today, the Exchange assesses a QCC Transaction Fee of \$0.20 per contract to a Specialist,<sup>3</sup> Market Maker,<sup>4</sup> Professional,<sup>5</sup> Firm<sup>6</sup> and Broker-Dealer.<sup>7</sup> Customers are not assessed a QCC Transaction Fee. The Exchange proposes to no longer assess Professionals a

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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> The term "Market Maker" includes Registered Options Traders ("ROT"). See Exchange Rule 1014 (b)(i) and (ii). A ROT includes a Streaming Quote Trader or "SQT," a Remote Streaming Quote Trader or "RSQT" and a Non-SQT, which by definition is neither a SQT nor a RSQT. A ROT is defined in Exchange Rule 1014(b) as a regular member or a foreign currency options participant of the Exchange located on the trading floor who has received permission from the Exchange to trade in options for his own account. An SQT is an ROT who has received permission from the Exchange to generate and submit option quotations electronically in options to which such SQT is assigned. See Rule 1014(b)(ii)(A). An RSQT is an ROT that is a member affiliated with and Remote Streaming Quote Organization with no physical trading floor presence who has received permission from the Exchange to generate and submit option quotations electronically in options to which such RSQT has been assigned. See Rule 1014(b)(ii)(B).

<sup>5</sup> 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). See Rule 1000(b)(14).

<sup>6</sup> The term "Firm" applies to any transaction that is identified by a member or member organization for clearing in the Firm range at The Options Clearing Corporation.

<sup>7</sup> The term "Broker-Dealer" applies to any transaction which is not subject to any of the other transaction fees applicable within a particular category.

QCC Transaction Fee.

### QCC Rebate

The Exchange also pays rebates on QCC Orders.<sup>8</sup> Rebates are paid for all qualifying executed QCC Orders, as defined in Rule 1080(o)<sup>9</sup> and Floor QCC Orders, as defined in Rule 1064(e),<sup>10</sup> except where the transaction is either: (i) Customer-to-Customer; or (ii) a dividend, merger, short stock interest or reversal or conversion strategy execution.<sup>11</sup> The maximum QCC Rebate to be paid in a given month will not exceed \$450,000.<sup>12</sup> The Exchange pays rebates to market participants acting as agent on qualifying QCC Orders. The Exchange proposes to no longer pay QCC Rebates on Customer-to-Professional orders.<sup>13</sup>

QCC Orders are an order to buy or sell at least 1,000 contracts, or 10,000 contracts in the case of Mini Options.<sup>14</sup> These large-sized contingent orders are complex in nature and have a stock-tied component, which requires the option leg to be executed at the NBBO or better. The parties to a contingent trade are focused on the spread or ratio between the transaction prices for each of the component instruments (i.e., the net price of the entire contingent trade), rather than

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<sup>8</sup> See Section II of the Pricing Schedule.

<sup>9</sup> A QCC Order is comprised of an originating order to buy or sell at least 1,000 contracts, or 10,000 contracts in the case of Mini Options, that is identified as being part of a qualified contingent trade, as that term is defined in Rule 1080(o)(3), coupled with a contra-side order or orders totaling an equal number of contracts. See Rule 1080(o).

<sup>10</sup> A Floor QCC Order must: (i) be for at least 1,000 contracts; (ii) meet the six requirements of Rule 1080(o)(3) which are modeled on the QCT Exemption; (iii) be executed at a price at or between the National Best Bid and Offer (“NBBO”); and (iv) be rejected if a Customer order is resting on the Exchange book at the same price. In order to satisfy the 1,000-contract requirement, a Floor QCC Order must be for 1,000 contracts and could not be, for example, two 500-contract orders or two 500-contract legs.

<sup>11</sup> See Section II of the Pricing Schedule.

<sup>12</sup> Id.

<sup>13</sup> At this time, the Exchange will continue to pay a QCC Rebate where the transaction is Professional-to-Professional.

<sup>14</sup> See notes 9 and 10 above.

on the absolute price of any single component. Permitting Professional orders to be treated similar to Customer orders with respect to this order type is reasonable because of the characteristics of the QCC Order which are described above.

The differentiation between a Customer and Professional is not necessary with respect to QCC Orders because these orders are exempt from requirements regarding order exposure.<sup>15</sup> Further, QCC Orders are not executed pursuant to a priority scheme.<sup>16</sup> Also, as explained above, because of the size of the order, sophistication of the investor and complexity of the transaction, it is difficult to distinguish as between a Customer and Professional with respect to QCC Orders.<sup>17</sup>

Finally, the Exchange believes that treating Customer orders and Professional orders in a similar manner with respect to fees, when transacting QCC Orders, will attract more QCC Orders to the Exchange because there would be no fee for Professional orders.

## 2. Statutory Basis

The proposal is consistent with Section 6(b) of the Act,<sup>18</sup> in general, and furthers the objectives of Sections 6(b)(4) and 6(b)(5) of the Act,<sup>19</sup> in particular, in that it provides for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system which the Exchange operates or controls, and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

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<sup>15</sup> See Rule 1080(c)(ii)(C).

<sup>16</sup> By way of comparison, Customers receive priority over other market participants with respect to the execution of their order within the Exchange's order book or on the Floor.

<sup>17</sup> A Professional transacting a QCC Order would count that order toward the 390 orders in listed options per day. See note 5 above.

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

<sup>19</sup> 15 U.S.C. 78f(b)(4) and (5).

The Commission and the courts have repeatedly expressed their preference for competition over regulatory intervention in determining prices, products, and services in the securities markets. In Regulation NMS, while adopting a series of steps to improve the current market model, the Commission highlighted the importance of market forces in determining prices and SRO revenues and, also, recognized that current regulation of the market system “has been remarkably successful in promoting market competition in its broader forms that are most important to investors and listed companies.”<sup>20</sup>

Likewise, in NetCoalition v. Securities and Exchange Commission (“NetCoalition”)<sup>21</sup> the D.C. Circuit upheld the Commission’s use of a market-based approach in evaluating the fairness of market data fees against a challenge claiming that Congress mandated a cost-based approach.<sup>22</sup> As the court emphasized, the Commission “intended in Regulation NMS that ‘market forces, rather than regulatory requirements’ play a role in determining the market data . . . to be made available to investors and at what cost.”<sup>23</sup>

Further, “[n]o one disputes that competition for order flow is ‘fierce.’ ... As the SEC explained, ‘[i]n the U.S. national market system, buyers and sellers of securities, and the broker-dealers that act as their order-routing agents, have a wide range of choices of where to route orders for execution’; [and] ‘no exchange can afford to take its market share percentages for granted’ because ‘no exchange possesses a monopoly, regulatory or otherwise, in the execution

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<sup>20</sup> See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37497, 37499 (June 29, 2005) (“Regulation NMS Adopting Release”).

<sup>21</sup> See Securities Exchange Act Release No. 51808 (June 9, 2005) at 534-535.

<sup>22</sup> See Securities Exchange Act Release No. 51808 (June 9, 2005) at 534.

<sup>23</sup> See Securities Exchange Act Release No. 51808 (June 9, 2005) at 537.

of order flow from broker dealers' ...."<sup>24</sup> Although the court and the SEC were discussing the cash equities markets, the Exchange believes that these views apply with equal force to the options markets.

It is reasonable to no longer assess a QCC Transaction Fee for Professional orders and to not pay a QCC Rebate on Customer-to-Professional orders because the distinction that necessitated the differentiation as between Customer and Professional orders is not meaningful with respect to QCC Orders. QCC Orders are orders to buy or sell at least 1,000 contracts, or 10,000 contracts in the case of Mini Options.<sup>25</sup> These large-sized contingent orders are complex in nature and have a stock-tied component, which requires the option leg to be executed at the NBBO or better. The parties to a contingent trade are focused on the spread or ratio between the transaction prices for each of the component instruments (i.e., the net price of the entire contingent trade), rather than on the absolute price of any single component. Also, no Customer priority exists with respect to QCC Orders as with orders transacted within the order book or on the Floor. Permitting Professional orders to be treated similar to Customer orders with respect to this order type will attract more QCC Orders to the Exchange because the Exchange would no longer assess a QCC Transaction Fee for Professional orders.

Further, the Exchange recently amended its definition of a Professional to add specificity with respect to the manner in which the volume threshold will be calculated to determine if orders should be treated as Professional.<sup>26</sup> Currently, member organizations are required to

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<sup>24</sup> See Securities Exchange Act Release No. 51808 (June 9, 2005) at 539 (quoting Securities Exchange Act Release No. 59039 (December 2, 2008), 73 FR 74770, 74782-83 (December 9, 2008) (SR-NYSEArca-2006-21).

<sup>25</sup> See notes 9 and 10 above.

<sup>26</sup> See Securities Exchange Act Release No. 77054 (February 4, 2016), 81 FR 7166 (February 10, 2016) (SR-Phlx-2016-10) (Notice of Filing of Proposed Rule Change

review their Customers' activity on at least a quarterly basis to determine whether orders that are not for the account of a broker-dealer should be represented as Customer orders or Professional orders.<sup>27</sup> The Exchange anticipates that the specificity added to the Professional definition may cause current market participants that mark orders as Customer to be required to mark those orders as Professional as the calendar quarter comes to a close. Orders that were marked Customer were not subject to a fee. With this proposal, Professional orders would not be assessed a QCC Transaction Fee. Furthermore, when a QCC Order is Customer-to-Customer or Customer-to-Professional the agent transacting the QCC Order will not be eligible to receive a QCC Rebate.

The Exchange believes that no longer assessing a QCC Transaction Fee for Professional orders and not paying a QCC Rebate on Customer-to-Professional orders is equitable and not unfairly discriminatory because QCC Orders are distinctive as compared to transactions executed within the order book or on the Floor, which orders are subject to exposure and grant Customers priority over other market participants. The original purpose for the distinction between a Customer and a Professional was to prevent market professionals<sup>28</sup> with access to sophisticated

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Relating to Professional Customer Definition). This rule change became operative on April 1, 2016.

<sup>27</sup> Orders for any Customer that had an average of more than 390 orders per day during any month of a calendar quarter must be represented as Professional orders for the next calendar quarter. Member organizations are required to conduct a quarterly review and make any appropriate changes to the way in which they are representing orders within five days after the end of each calendar quarter. While member organizations will only be required to review their accounts on a quarterly basis, if during a quarter the Exchange identifies a Customer for which orders are being represented as Customer orders but that has averaged more than 390 orders per day during a month, the Exchange will notify the member organization and the member organization will be required to change the manner in which it is representing the Customer's orders within five days. See Id. at 7165, n.5.

<sup>28</sup> The Exchange noted in its filing that market professionals have access to functionality, including things such as continuously updated pricing models based upon real-time streaming data, access to multiple markets simultaneously and order and risk

trading systems that contain functionality not available to retail Customers, from taking advantage of Customer priority, where Customer orders are given execution priority over non-Customer orders. The Exchange noted at the time that it adopted the Professional designation that identifying Professional accounts based upon the average number of orders entered for a beneficial account was an appropriate objective approach that would reasonably distinguish such persons and entities from retail investors.<sup>29</sup> QCC Orders are by definition large-sized contingent orders which have a stock-tied component.

With respect to QCC transactions, the Commission noted in an order approving a qualified contingent cross order type on International Securities Exchange, LLC (“ISE”) that “The Commission believes that those customers participating in QCC Orders will likely be sophisticated investors who should understand that, without a requirement of exposure for QCC Orders, their order would not be given an opportunity for price improvement on the Exchange. These customers should be able to assess whether the net prices they are receiving for their QCC Order are competitive, and who will have the ability to choose among broker-dealers if they believe the net price one broker-dealer provides is not competitive. Further, broker-dealers are subject to a duty of best execution for their customers' orders, and that duty does not change for QCC Orders.”<sup>30</sup> The intent behind the Professional designation does not apply in the context of transacting QCC Orders, because of the size of the order, sophistication of the investor and complexity of the transaction, and therefore the pricing differentiation is not necessary. For

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management tools. See Securities and Exchange Act Release No. 61426 (January 26, 2010), 75 FR 5360 (February 2, 2010) (SR-Phlx-2010-05).

<sup>29</sup> See Securities and Exchange Act Release No. 61426 (January 26, 2010), 75 FR 5360 (February 2, 2010) (SR-Phlx-2010-05).

<sup>30</sup> See Securities and Exchange Act Release No. 63955 (February 24, 2011), 76 FR 11533 (March 2, 2011) (SR-ISE-2010-73).



these reasons the Exchange believes that distinguishing a Customer order from a Professional order is not necessary with respect to QCC Orders.

With respect to distinguishing Professional orders from other Non-Customer participant orders, the Exchange notes that these other market participants are distinct from a Professional for purposes of assessing QCC Transaction fees for the below reasons. With respect to Firms, these market participants are eligible for the Monthly Firm Fee Cap of \$75,000 per month.<sup>31</sup> Firms are not subject to QCC Transaction Fees once the Monthly Firm Fee Cap is met in a given month. Specialists and Market Makers are eligible for the Monthly Market Maker Cap of \$500,000 per month.<sup>32</sup> Specialists and Market Makers are not subject to QCC Transaction Fees once the Monthly Market Maker Cap is met in a given month. Professionals are not subject to similar caps. With respect to Broker-Dealers, the Exchange notes that members may choose to register as a Broker-Dealer. This category of market participant transacts QCC Orders on an agency basis and receives eligible rebates pursuant to the QCC Rebate Schedule.<sup>33</sup> By way of example, presume a Customer order to buy 10,000 contracts eligible as a QCC Order. Presume the selling contra-parties to this order are a Customer, Professional, Firm, Specialist and Broker-

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<sup>31</sup> Firms are subject to a maximum fee of \$75,000 (“Monthly Firm Fee Cap”). Firm Floor Option Transaction Charges and QCC Transaction Fees, in the aggregate, for one billing month will not exceed the Monthly Firm Fee Cap per member organization when such members are trading in their own proprietary account. See Section II of the Pricing Schedule.

<sup>32</sup> Specialists and Market Makers are subject to a “Monthly Market Maker Cap” of \$500,000 for: (i) electronic Option Transaction Charges; and (ii) QCC Transaction Fees (as defined in Exchange Rule 1080(o) and Floor QCC Orders, as defined in 1064(e)). The trading activity of separate Specialist and Market Maker member organizations will be aggregated in calculating the Monthly Market Maker Cap if there is Common Ownership between the member organizations. See Section II of the Pricing Schedule.

<sup>33</sup> QCC Rebates are paid by volume. There are currently six tiers which pay a QCC Rebate between \$0.00 and \$0.11 per contract. See Section II of the Pricing Schedule. Of note, market participants may transact QCC Orders on an agency basis and be eligible for a QCC Rebate.

Dealer each with 2,000 contracts. In this example, the Customer buying order will not be subject to a QCC Transaction Fee. The Customer selling order would not be subject to a fee or rebate. The Professional selling order would not be subject to a fee or rebate as proposed herein. Orders for Firms, Specialists and Broker-Dealers would be assessed a \$0.20 per contract QCC Transaction Fee and would be eligible for rebates pursuant to the QCC Rebate Schedule. Market participants acting as agent, as compared to market participants trading for their own account, are eligible to receive QCC Rebates. The Exchange pays QCC Rebates to market participants acting as agent for QCC Orders, subject to the QCC Rebate Schedule.

The Exchange believes that distinguishing Professional orders from other Non-Customer orders is equitable and not unfairly discriminatory because with respect to QCC Orders it is difficult to distinguish a Customer order from a Professional order. QCC Orders are an exception to the general distinctions drawn as between Customer orders and Professional orders. Aside from the lack of priority for QCC Orders, the size of the order, sophistication of the investor and complexity of the transaction make it difficult to distinguish a Customer order from a Professional order. For purposes of the QCC Order, the Exchange believes that such distinction is not necessary.

Further, the Exchange's proposal would continue to assess all other market participants a QCC Transaction Fee of \$0.20 per contract. Also, Customer-to-Professional orders will not be eligible for a QCC Rebate for the reasons explained herein.

**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. In terms of inter-market competition, the Exchange notes that it operates in a highly competitive market in

which market participants can readily favor competing venues if they deem fee levels at a particular venue to be excessive, or rebate opportunities available at other venues to be more favorable. In such an environment, the Exchange must continually adjust its fees to remain competitive with other exchanges and with alternative trading systems that have been exempted from compliance with the statutory standards applicable to exchanges. Because competitors are free to modify their own fees in response, and because market participants may readily adjust their order routing practices, that the degree to which fee changes in this market may impose any burden on competition is extremely limited.

The initial purpose of the distinction between a Customer order and a Professional order was to prevent market professionals with access to sophisticated trading systems that contain functionality not available to retail customers, from taking advantage of Customer priority, where Customer orders are given execution priority over Non-Customer orders. Professional orders are identified based upon the average number of orders entered for a beneficial account.<sup>34</sup>

QCC Orders are by definition large-sized contingent orders which have a stock-tied component. The parties to a contingent trade are focused on the spread or ratio between the transaction prices for each of the component instruments (i.e., the net price of the entire contingent trade), rather than on the absolute price of any single component. Treating Customer orders and Professional orders in the same manner in terms of pricing with respect to QCC Orders does not provide any advantage to a Professional. The distinction does not create an opportunity to burden competition, for the reasons stated herein with respect to priority as well as the reasons below.

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<sup>34</sup> See note 5.

With respect to distinguishing Professional orders from other Non-Customer orders, the Exchange notes that Non-Customer orders are distinct from Professional orders for purposes of assessing QCC Transaction fees. Firms are eligible for the Monthly Firm Fee Cap and not subject to QCC Transaction Fees once the Monthly Firm Fee Cap is met in a given month.<sup>35</sup> Specialists and Market Makers are eligible for the Monthly Market Maker Cap and not subject to QCC Transaction Fees once the Monthly Market Maker Cap is met in a given month.<sup>36</sup> Professionals are not subject to similar caps. With respect to Broker-Dealers, the Exchange notes that members may choose to register as a Broker-Dealer. This category of market participant transacts QCC Orders on an agency basis and is eligible to receive QCC Rebates. Further, the Exchange's proposal would continue to assess Specialist, Market Maker, Firm and Broker-Dealer orders similar to QCC Transaction Fee of \$0.20 per contract. Also, Customer-to-Professional orders do not impose an undue burden on intra-market competition for the reasons explained herein.

The Exchange's proposal does not place an undue burden on inter-market competition because the QCC order type is similar on other options exchanges<sup>37</sup> and these exchanges may also file to eliminate the distinction between Customers and Professionals for the QCC order type.

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.

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<sup>35</sup> Market participants acting as agents would be eligible to receive a QCC Rebate.

<sup>36</sup> Specialists and Market Makers trade only for their own account.

<sup>37</sup> See Chicago Board Options Exchange, Incorporated's Fees Schedule and Miami International Securities Exchange LLC's Pricing Schedule.

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act.<sup>38</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 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-2016-51 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-2016-51. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your

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<sup>38</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

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-2016-51 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>39</sup>

Brent J. Fields  
Secretary

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<sup>39</sup> 17 CFR 200.30-3(a)(12).