

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-79221; File No. SR-Phlx-2016-107)

November 2, 2016

Self-Regulatory Organizations; NASDAQ PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend Exchange Rule 1079 Concerning the Process of Initiating a FLEX Transaction and Determining the Best Bid or Offer

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 October 19, 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 Exchange Rule 1079, FLEX Index, Equity, and Currency Options, at Section (b), Procedure for Quoting and Trading FLEX Options.

The text of the proposed rule change is available on the Exchange’s Website at <http://nasdaqphlx.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

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

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

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 Exchange proposes to amend section (b), Procedure for Quoting and Trading FLEX Options, of Rule 1079. Specifically, the Exchange proposes to amend subsection (1), Requesting Quotations, by largely reversing the changes it made to that subsection in a 2013 proposed rule change (the “2013 Amendments”).<sup>3</sup> The changes proposed herein deal only with the process of initiating a FLEX transaction and determining the best bid or offer (“BBO”). No other aspects of Rule 1079, as changed by the 2013 Amendments, are proposed to be amended.

FLEX option transactions on the Exchange are governed by Rule 1079. Under Rule 1079(b) a Requesting Member may obtain quotes and execute trades in certain non-listed FLEX options at the specialist post of the non-FLEX option on the Exchange. The Requesting Member is a Phlx member, qualified to trade FLEX options pursuant to paragraph (c) of Rule 1079, who initiates a FLEX Request For Quotes (“RFQ”) pursuant to Rule 1079(b).<sup>4</sup> FLEX options are not continuously quoted and series are not pre-established. Moreover, the Exchange’s electronic quoting and trading system is not

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<sup>3</sup> See Securities Exchange Act Release No. 69586 (May 15, 2013), 78 FR 29797 (May 21, 2013) (SR-Phlx-2013-50) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to FLEX Options).

<sup>4</sup> All transactions must be in compliance with Section 11(a) of the Securities Exchange Act of 1934 and the rules promulgated thereunder, which may include yielding priority to customer orders.

available for FLEX options. The variable terms of FLEX options are established through the process described in Rule 1079.

Pursuant to the 2013 Amendments, the Exchange revised a number of its FLEX rules, which it stated were intended to be similar to those of NYSE MKT LLC (“Amex”). Rule 1079(b)(1) was revised to require the Requesting Member to submit to the FLEX Specialist an RFQ utilizing for that purpose the forms, formats and procedures established by the Exchange. The 2013 Amendments also amended Rule 1079(b)(1) to provide that, on receipt of an RFQ in proper form, the assigned FLEX Specialist shall cause the terms and specifications of the RFQ to be immediately announced at the post. Thus, the 2013 Amendments added new requirements mandating the participation of an assigned FLEX Specialist at the inception of every FLEX transaction.

Prior to the 2013 Amendments, Rule 1079(b)(1) permitted a Requesting Member to initiate an RFQ without the participation of a FLEX Specialist, by first announcing all of the following contract terms to the trading crowd of the non-FLEX option and then submitting an RFQ ticket to that specialist post: (1) underlying index, security or foreign currency; (2) type, size, and crossing intention; (3) in the case of FLEX index options and FLEX equity options, exercise style; (4) expiration date; (5) exercise price; and (6) respecting index options, the settlement value. Thereafter, on receipt of an RFQ in proper form, the assigned Specialist or Requesting Member was required to cause the terms of the RFQ to be disseminated as an administrative text message through the

Options Price Reporting Authority (“OPRA”). Operationally, the Requesting Member provided this information to Exchange staff who entered it into Exchange systems.<sup>5</sup>

Because most Exchange specialists no longer have a presence on the Exchange’s trading floor, and are therefore unable to trade FLEX options, and because Exchange specialists (remote or otherwise) may have no interest in being an assigned FLEX Specialist in any event, the Exchange proposes to revert to Rule 1079(b)(1) largely as it read prior to the 2013 Amendments. That language did not require the participation of a FLEX Specialist to initiate a FLEX trade. As revised, the rule will once again permit FLEX transactions to be initiated without the participation of a specialist so long as all other requirements of Rule 1079 have been met, consistent with the intent of the original proposed rule change adopting the Rule 1079 provisions applicable to FLEX equity and index options.<sup>6</sup>

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<sup>5</sup> See Securities Exchange Act Release No. 39549 (January 14, 1998), 63 FR 3601 (January 23, 1998) (Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 2, 4, and 5 to the Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to the Listing of Flexible Exchange Traded Equity and Index Options) (SR-Phlx-96-38) (the “1998 Approval Order”) at footnote 36. The 2013 Amendments also revised Rule 1079(b)(1) by eliminating the original requirement that the assigned Specialist or the Requesting Member cause the terms of the RFQ to be disseminated as an OPRA text message, and by substituting for that original requirement a statement, in passive voice that does not specify on whom the obligation is imposed, that the terms and specifications of the RFQ “shall be disseminated as an administrative text message through OPRA.” As a matter of practice today, the Requesting Member still provides this information to Exchange staff who enter it into Exchange systems.

<sup>6</sup> The 1998 Approval Order specifically anticipated that FLEX trading may occur without the participation of a Specialist, stating that “the Exchange also notes that there may not be a Specialist in FLEX options” and that “[a]t least two Exchange members (ROTs and/or a Specialist) shall be assigned to each FLEX option. If there is an assigned Specialist and an assigned ROT, the FLEX option will trade pursuant to the specialist system, just as non-FLEX options currently do on the Exchange. If, however, there is no assigned Specialist in a FLEX option, two

The Exchange did not intend for the 2013 Amendments to expand the role of a FLEX Specialist beyond the provisions of Rule 1079(b)(1) that the Exchange is now proposing to roll back to their wording prior to the 2013 Amendments. Because the Exchange did not intend for the 2013 Amendments to expand the role of a FLEX Specialist in any case, the current proposed change to roll Rule 1079(b)(1) back to its wording prior to the 2013 Amendments will have no collateral consequences for the FLEX trading process under the rest of Rule 1079's provisions. In particular, the Exchange notes that the BBO (the best bid, offer or both, as applicable, entered in response to an RFQ) can be determined by the Requesting Member, without the assistance or intervention of a FLEX Specialist, consistent with the original 1998 Approval Order.<sup>7</sup> Removing the requirement that a FLEX Specialist receive the RFQ and announce its terms and conditions to the crowd should have no effect on the remaining processes outlined in Rule 1079 for the trading in FLEX options.

In practice, initially due to oversight by Exchange staff, the Exchange has not required the participation of an assigned FLEX Specialist as provided for in the 2013 Amendments but has instead continued to permit FLEX trading to occur without an assigned FLEX Specialist, just as FLEX trading has been conducted since the original

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assigned ROTs are required for that FLEX option to trade.” If there were no assigned FLEX Specialist, the process for trading the FLEX option would unfold between and among the crowd participants, without involvement of an assigned FLEX Specialist, as described in Rule 1079. The Exchange notes that the 2013 Amendments also eliminated the rule previously found at Rule 1079(b)(5)(B) providing for the maintenance by a specialist of a FLEX book and governing trading with booked FLEX orders.

<sup>7</sup> Prior to the 2013 Amendments, former Rule 1079(b)(3) specifically provided that the Requesting Member was to determine the BBO if there were no assigned Specialist. The Exchange proposes to reinsert this language into Rule 1079(b)(3), for clarity.

1998 Approval Order. Further, the negative practical effects of the superfluous FLEX Specialist participation requirement appear to have been inadequately considered by the Exchange when the requirement was initially adopted in the 2013 Amendments as a very small part of a more extensive set of amendments to Rule 1079 dealing with unrelated matters.<sup>8</sup> As noted above, the Exchange advanced no policy reason for the requirement when it was adopted other than a general desire to track the language of another exchange's FLEX rule. It identified no problem that the Specialist participation requirement was intended to remedy. The Exchange now desires to eliminate the needless requirement, originally added in the 2013 Amendments for no substantive reason, and return Rule 1079(b)(1) to its previous language pursuant to which FLEX option transactions have been successfully executed since the 1998 Approval Order.

Finally, the Exchange proposes to amend the introductory language to Rule 1079, which provides that a Requesting Member shall obtain quotes and execute trades in certain non-listed FLEX options at the specialist post of the non-FLEX option on the Exchange. The Exchange proposes to delete the reference to the "specialist" post, which is a term no longer commonly used at the Exchange. Rather, the area where an option is traded is now simply referred to as a post.<sup>9</sup>

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<sup>8</sup> For example, the Exchange stated in the 2013 Amendments that it proposed to adopt rules, similar to Amex, which require a Requesting Member to submit to the FLEX Specialist an RFQ and that on receipt of an RFQ in proper form, the assigned FLEX Specialist shall cause the terms and specifications to be immediately announced at the post. The proposed rule change thus assumed the existence of a FLEX Specialist even though the FLEX rules at the time provided for FLEX trading without any FLEX Specialist.

<sup>9</sup> For the same reason, in the proposed amendments to Rule 1079(b)(1) the Exchange is using the term "post" rather than the term "specialist post" that was used in the Rule 1079(b)(1) language in place prior to the 2013 Amendments.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>10</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>11</sup> 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, because the Commission has previously approved the proposed language in the 1998 Approval Order. The proposal eliminates a requirement that a FLEX Specialist participate in the initiation of every FLEX transaction which, given the general absence of specialists on the Exchange trading floor, may needlessly constrain FLEX trading. Importantly, as stated above, the Exchange's 2013 Amendments did not advance a particular policy or reason for amending the Rule 1079(b)(1) language or the language in Rule 1079(b)(3) permitting the Requesting Member to determine the BBO in the absence of an assigned Specialist, other than a general intent to track Amex rule language. There is consequently no policy reason not to return the rule language to the wording as it existed prior to the 2013 Amendments.

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

The Exchange does not believe that amendments proposed herein will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act inasmuch as they simply reinstate previous Exchange rule language which had been approved by the Commission, and remove an outdated reference to the specialist post.

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

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

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

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

<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.



#### 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-2016-107 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 20549-1090.

All submissions should refer to File Number SR-Phlx-2016-107. 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 Web site (<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-2016-107 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).