

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-79322; File No. SR-Phlx-2016-97)

November 16, 2016

Self-Regulatory Organizations; NASDAQ PHLX LLC; Order Granting Approval of Proposed Rule Change to Delete Outdated or Unnecessary Rule Language in Phlx Rule 1020

I. Introduction

On September 27, 2016, NASDAQ PHLX LLC (“Exchange” or “Phlx”) filed with the Securities and Exchange Commission (“SEC” or “Commission”), 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> a proposed rule change to delete or amend its rules relating to specialists. The proposed rule change was published for comment in the Federal Register on October 14, 2016.<sup>3</sup> The Commission received no comment letters on the proposed rule change. This order approves the proposed rule change.

II. Description of the Proposal

Phlx Rule 1020 contains provisions relating to the registration and functions of options specialists.<sup>4</sup> Section (b) provides that a member registered as a specialist in one or more options has an obligation to assist in the maintenance of a fair and orderly market, “in addition to the execution of orders entrusted to him in such options.” The Exchange proposes to delete the language in section (b) regarding execution of entrusted orders. The Exchange represents that

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

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

<sup>3</sup> See Securities Exchange Act Release No. 79073 (October 11, 2016), 81 FR 71153 (October 14, 2016) (“Notice”).

<sup>4</sup> A “specialist” is an Exchange member who is registered as an options specialist pursuant to Phlx Rule 1020(a). Specialists are subject to quoting and registration obligations set forth in Phlx Rules 1014(b), 1020 and 1080.02.

today, specialists on the Exchange trade only for their own account and “no longer handle any agency orders whatsoever in their role as specialists.”<sup>5</sup>

Commentary .01 of Phlx Rule 1020 provides that in “effecting transactions” for a specialist’s own account for the purpose of establishing or increasing a position, a specialist is to effect such transactions in a reasonable and orderly manner in relation to the condition of the general market, the market in the particular option, and the adequacy of his position to the immediate and reasonably anticipated needs of the options market. Commentary .01 sections (a) through (d) provide that certain types of transactions to establish or increase a position are not to be effected except when they are reasonably necessary to render the specialist’s position adequate to such needs.<sup>6</sup> The Exchange proposes to delete the last sentence of Commentary .01 and sections (a) through (d). The Exchange represents that today, specialists do not “effect transactions” in the sense of matching bids and offers to cause a transaction execution, except in

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<sup>5</sup> See Notice, supra note 3, at 71154.

<sup>6</sup> Specifically, Commentary .01 sections (a) through (d) provide that the following types of transactions to establish or increase a position are not to be effected except when they are reasonably necessary to render the specialist’s position adequate to such needs: (a) a purchase at a price above the last sale in the same trading session; (b) the purchase of all or substantially all the options offered on the book at a price equal to the last sale, when the option so offered represents all or substantially all the options offered in the market; and when a substantial amount of an option is offered at a price equal to the last sale price, the purchase of more than 50% of all the options offered at the last sale price; (c) the supplying of all or substantially all the options bid for on the book at a price equal to the last sale, when the option so bid for represents all or substantially all the options bid for in the market; and when a substantial amount of the options bid for at a price equal to the last sale price, the supplying of more than 50% of all the options bid for at the last sale price; (d) failing to re-offer or re-bid where necessary after effecting transactions described in (a), (b), or (c). The rule permits transactions of these types to be effected, however, with the approval of an Options Exchange Official or in relatively inactive markets where they are an essential part of a proper course of dealings and where the amount of an option involved and the price change, if any, are normal in relation to the market.

rare cases.<sup>7</sup> Instead, specialists submit bids and offers to be matched by the PHLX XL trading system.<sup>8</sup> Therefore, the Exchange believes that the specialist may be unable to determine the price of the last sale, which would be required for a specialist to comply with the language Phlx proposes to be deleted.

Commentary .02 of Phlx Rule 1020 provides that, for transactions of a specialist for his own account that liquidate or decrease his position in an option in which he is registered, such transactions are to be “effected” in a reasonable and orderly manner in relation to the condition of the general market, the market in the particular option, and the adequacy of the specialist’s positions to the immediate and reasonably anticipated needs of the options market. Commentary .02 sections (a) through (c) describe certain restrictions on specialists when liquidating or decreasing such positions.<sup>9</sup> The Exchange proposes to delete part of the last sentence of Commentary .02 and sections (a) through (c). The Exchange represents that, as discussed above, a specialist may be unable to determine the “last different price” as required to comply with sections (a) and (c).<sup>10</sup> The Exchange believes also that section (b) is redundant to Rule 1020(b), which already contains the “fair and orderly” requirement.<sup>11</sup>

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<sup>7</sup> See Notice, supra note 3, at 71154. The Exchange represents that although a specialist may “effect transactions” with a market maker on the Exchange’s trading floor, the vast majority of transactions are executed electronically by the trading system.

<sup>8</sup> See id.

<sup>9</sup> Commentary .02 sections (a) through (c) also provide that, unless he has the prior approval of an Options Exchange Official, he should avoid: (a) liquidation of all or substantially all of a position by selling options at prices below the last different price or by purchasing options at prices above the last different price unless such transactions are reasonably necessary in relation to the specialist’s overall position in the options in which he is registered; (b) failing to maintain a fair and orderly market during liquidations; or (c) failing to re-enter the market where necessary, after effecting transactions described in (a) above.

<sup>10</sup> See Notice, supra note 3, at 71155.

<sup>11</sup> See id.

Commentary .03 of Phlx Rule 1020 provides that a specialist's quotation, made for his own account, should be such that a transaction effected at his quoted price or within the quoted spread, whether having the effect of reducing or increasing the specialist's position, would bear a proper relation to preceding transactions and anticipated succeeding transactions. The Exchange proposes to delete Commentary .03. The Exchange represents that, due to the speed of trading that occurs today on the Phlx XL trading system, specialists may not have knowledge of preceding transactions and would not be able to adjust quotes as needed to comply with Commentary .03 before the quotes are accessed.<sup>12</sup>

Commentary .04 of Phlx Rule 1020 provides that a specialist should avoid participating as a dealer in opening or reopening an option in such a manner as to reverse the balance of public supply and demand as reflected by market and limited price orders at or near the price of the previous close or halt, unless the condition of the general market or the specialist's position in light of the reasonably anticipated needs of the market make it advisable to do so, or unless the specialist has obtained the prior approval of an Options Exchange Official to do so. The commentary provides that he may, however, buy or sell an option as a dealer to minimize the disparity between supply and demand at an opening or reopening. The Exchange proposes to delete Commentary .04. The Exchange represents that a specialist no longer manually opens options classes; the PHLX XL trading system handles the opening and reopening of options.<sup>13</sup>

Commentary .05 of Phlx Rule 1020 prohibits a member acting as a specialist from effecting transactions for the purpose of adjusting a LIFO inventory in an option in which he is

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<sup>12</sup> See id.

<sup>13</sup> See id.

acting except as is reasonably necessary to assist in the maintenance of a fair and orderly market. The Exchange believes that Commentary .05 is no longer necessary and proposes to delete it.<sup>14</sup>

Commentary .06 of Phlx Rule 1020 restricts a specialist from assigning options in which he is registered to an investment account. The Commentary states that a specialist may not add to a position in an investment account unless reasonably necessary to permit the specialist to assist in the maintenance of a fair and orderly market. Furthermore, a specialist may not effect a transfer of options in which he is registered from his dealer account to an investment account if the transfer would result in a short position in the dealer account. The Commentary also provides that in the maintenance of price continuity with reasonable depth, it is commonly desirable for a specialist to supply options to the market, even though he may have to sell short to do so, to the extent reasonably necessary to meet the needs of the market. The Exchange proposes to delete Commentary .06 because investment accounts are no longer used by specialists.<sup>15</sup>

### III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and rules and regulations thereunder applicable to a national securities exchange.<sup>16</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>17</sup> which requires, among other things, that the rules of a national securities exchange be 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

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<sup>14</sup> See id.

<sup>15</sup> See id.

<sup>16</sup> In approving the proposed rule changes, the Commission has considered their impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>17</sup> 15 U.S.C. 78f(b)(5).

market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers. The Commission believes that the deletion of Phlx Rules 1020(b), Commentary .01, Commentary .02 (a) and (c), Commentary .03, Commentary .04, and Commentary .06 should protect investors by helping to ensure that the Phlx rules accurately describe the current operations of the Exchange and obligations of its members. In addition, the Commission notes that the deletion of Commentary .02 (b) to remove redundant rule language should add clarity to Phlx's rules and that the deletion of Commentary .05 and Commentary .06 should provide more clarity regarding the obligations of specialists on the Exchange.

Accordingly, for the reasons discussed above, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act.

V. Conclusion

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Act<sup>18</sup> that the proposed rule change (SR-PHLX-2016-97) be and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>19</sup>

Brent J. Fields  
Secretary

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<sup>18</sup> 15 U.S.C. 78s(b)(2).

<sup>19</sup> 17 CFR 200.30-3(a)(12).