

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-82008; File No. SR-Phlx-2017-88)

November 3, 2017

Self-Regulatory Organizations; Nasdaq PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend the Exchange's Pricing Schedule at Section IV, entitled "Other Transaction 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 October 30, 2017, 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 IV, entitled "Other Transaction Fees." Specifically, the Exchange proposes to amend its subsidy program, the Market Access and Routing Subsidy or "MARS," for Phlx members that provide certain order routing functionalities<sup>3</sup> to other Phlx members and/or use such functionalities themselves.

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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> The order routing functionalities permit a Phlx member to provide access and connectivity to other members as well utilize such access for themselves. The Exchange notes that under this arrangement one Phlx member may be eligible for payments under MARS, while another Phlx member might potentially be liable for transaction charges associated with the execution of the order, because those orders were delivered to the Exchange through a Phlx member's connection to the Exchange and that member qualified for the MARS Payment. Consider the following example: both members A and B are Phlx members but A does not utilize its own connections to route orders to the Exchange, and instead utilizes B's connections. Under this program, B will be eligible for the MARS Payment while A is liable for any transaction charges resulting from the execution of orders that originate from A, arrive at the Exchange via B's connectivity,

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 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

Phlx proposes to amend its subsidy program, MARS, which pays a subsidy to Phlx members that provide certain order routing functionalities to other Phlx members and/or use such functionalities themselves. Generally, under MARS, Phlx pays participating Phlx members to subsidize their costs of providing routing services to route orders to Phlx. The Exchange believes that MARS will continue to attract higher volumes of electronic equity and ETF options

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and subsequently execute and clear at The Options Clearing Corporation or "OCC," where A is the valid executing clearing member or give-up on the transaction. Similarly, where B utilizes its own connections to execute transactions, B will be eligible for the MARS Payment, but would also be liable for any transaction resulting from the execution of orders that originate from B, arrive at the Exchange via B's connectivity, and subsequently execute and clear at OCC, where B is the valid executing clearing member or give-up on the transaction.

volume to the Exchange from non-Phlx market participants as well as Phlx members with the proposed amendments.

Today, to qualify for MARS, a Phlx member's order routing functionality would be required to meet certain criteria.<sup>4</sup> With respect to Complex Orders, the Exchange would not require Complex Orders to enable the electronic routing of orders to all of the U.S. options exchanges or provide current consolidated market data from the U.S. options exchanges. Any Phlx member may apply for MARS, provided the requirements are met, including a robust and reliable System. The member is solely responsible for implementing and operating its System.

Today, a MARS Payment would be made to Phlx members that have System Eligibility and have routed the requisite number of Eligible Contracts daily in a month, which were executed on Phlx. For the purpose of qualifying for the MARS Payment, Eligible Contracts include Firm,<sup>5</sup> Broker-Dealer,<sup>6</sup> Joint Back Office or "JBO"<sup>7</sup> or Professional<sup>8</sup> equity option orders

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<sup>4</sup> Specifically the member's routing system (hereinafter "System") would be required to: (1) enable the electronic routing of orders to all of the U.S. options exchanges, including Phlx; (2) provide current consolidated market data from the U.S. options exchanges; and (3) be capable of interfacing with Phlx's API to access current Phlx match engine functionality. The member's System would also need to cause Phlx to be one of the top three default destination exchanges for individually executed marketable orders if Phlx is at the national best bid or offer ("NBBO"), regardless of size or time, but allow any user to manually override Phlx as the default destination on an order-by-order basis. The Exchange does not require Complex Orders to enable the electronic routing of orders to all of the U.S. options exchanges or provide current consolidated market data from the U.S. options exchanges.

<sup>5</sup> The term "Firm" or ("F") applies to any transaction that is identified by a Participant for clearing in the Firm range at OCC.

<sup>6</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.

<sup>7</sup> The term "Joint Back Office" or "JBO" applies to any transaction that is identified by a member or member organization for clearing in the Firm range at OCC and is identified with an origin code as a JBO. A JBO will be priced the same as a Broker-Dealer. A JBO participant is a member, member organization or non-member organization that maintains a JBO arrangement with a clearing broker-dealer ("JBO Broker") subject to the

that are electronically delivered and executed. Eligible Contracts do not include floor-based orders, qualified contingent cross or “QCC” orders,<sup>9</sup> price improvement or “PIXL” orders,<sup>10</sup> Mini-Option orders<sup>11</sup> or Singly-Listed Options<sup>12</sup> orders. The Eligible Contracts requirements are not being amended.

Phlx members that have System Eligibility and have executed the requisite number of Eligible Contracts in a month are paid rebates today as follows:

<b>Tiers</b>	<b>Average Daily Volume (“ADV”)</b>	<b>MARS Payment</b>
1	1,000	\$0.01
2	27,500	\$0.08
3	32,500	\$0.10
4	40,000	\$0.12

With respect to the MARS program, the Exchange proposes two sets of changes. First, the Exchange proposes to change the eligibility criteria for the program so that, instead of requiring the member’s System to designate Phlx to be one of the top three default destination

requirements of Regulation T Section 220.7 of the Federal Reserve System as further discussed at Exchange Rule 703.

<sup>8</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>9</sup> A QCC Order is comprised of an order to buy or sell at least 1000 contracts 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 to buy or sell an equal number of contracts. The QCC Order must be executed at a price at or between the NBBO and be rejected if a Customer order is resting on the Exchange book at the same price. A QCC Order shall only be submitted electronically from off the floor to the Exchange’s match engine. See Rule 1080(o).

<sup>10</sup> PIXL is the Exchange’s price improvement mechanism known as Price Improvement XL or (PIXL<sup>SM</sup>). See Rule 1080(n).

<sup>11</sup> Mini Options are further specified in Phlx Rule 1012, Commentary .13.

<sup>12</sup> Singly Listed Options are options overlying currencies, equities, ETFs, ETNs treasury securities and indexes not listed on another exchange.

exchanges for individually executed marketable orders (if Phlx is at the NBBO), the Rule would require the member’s System to designate Phlx to be one of the top five default designation exchanges in those circumstances. The Exchange proposes this change in recognition of the increasing number of options trading venues that exist and the desire of members for additional flexibility to route orders to such venues.

Second, the Exchange proposes to replace the existing MARS Payment schedule in its entirety with a new schedule that will include all new ADV tiers as well as different rebate amounts that depend upon whether the Eligible Contracts that a member executes at a particular ADV tier are in Standard and Poor’s Depository Receipts/SPDRs (“SPY”)<sup>13</sup> or not. The proposed tier schedule is as follows:

Tiers	Average Daily Volume (“ADV”)	MARS Payment	
		Non-SPY	SPY
1	1,000	\$0.01	\$0.01
2	30,000	\$0.10	\$0.10
3	40,000	\$0.12	\$0.12
4	52,500	\$0.14	\$0.12
5	65,000	\$0.18	\$0.12
6	75,000	\$0.20	\$0.12

As is the case today, no payment will be made with respect to orders that are routed to Phlx, but not executed.<sup>14</sup>

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>15</sup> in general, and furthers the objectives of Sections 6(b)(4) and 6(b)(5) of the Act,<sup>16</sup> in particular, in

<sup>13</sup> Options overlying Standard and Poor’s Depository Receipts/SPDRs (“SPY”) are based on the SPDR exchange-traded fund (“ETF”), which is designed to track the performance of the S&P 500 Index.

<sup>14</sup> A Phlx member will not be entitled to receive any other revenue for the use of its System specifically with respect to orders routed to Phlx with the exception of the Marketing Fee.

that it provides for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility, and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

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>17</sup>

Likewise, in NetCoalition v. Securities and Exchange Commission<sup>18</sup> (“NetCoalition”) 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>19</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>20</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-

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

<sup>16</sup> 15 U.S.C. 78f(b)(4) and (5).

<sup>17</sup> Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37499 (June 29, 2005) (“Regulation NMS Adopting Release”).

<sup>18</sup> NetCoalition v. SEC, 615 F.3d 525 (D.C. Cir. 2010).

<sup>19</sup> See NetCoalition, at 534 - 535.

<sup>20</sup> Id. at 537.

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 of order flow from broker dealers’ ....”<sup>21</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.

The Exchange believes that its proposal is reasonable to relax its MARS eligibility criteria so that members’ Systems need only designate Phlx to be among their top five (rather than top three) default destination exchanges for individually executed marketable orders. The Exchange recognizes that the number of options trading venues has increased over the last few years and that members may desire or require flexibility to route orders to these venues. The proposal accommodates members in this respect without compromising their ability to participate in the MARS program. The proposal is not unfairly discriminatory in that the relaxed criteria will apply equally to all those who participate in the MARS program.

The Exchange also believes that its proposal is reasonable to replace the existing MARS Payment schedule with a new schedule comprising new ADV tiers. The proposed schedule is designed to attract higher volumes of electronic equity and ETF options orders to the Exchange, which will, in turn, benefit all Phlx members by offering greater price discovery, increased transparency, and an increased opportunity to trade on the Exchange. The Exchange intends for the proposed schedule to achieve these results by increasing the number of ADV tiers in the schedule from four to six and, at each tier, paying a rebate that will be roughly the same as or

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

greater than that which it pays now.<sup>22</sup> For example, proposed Tiers 4, 5, and 6 will entitle members to receive payments of \$0.14, \$0.18, and \$0.20 for non-SPY executions, respectively, and \$0.12 for SPY executions, whereas the current top rebate is \$0.12 for all types and volumes of executions.

The proposed tier structure will also allow Phlx members to price their services at a level that will enable them to attract order flow from market participants who would otherwise utilize an existing front-end order entry mechanism offered by the Exchange's competitors instead of incurring the cost in time and money to develop their own internal systems to be able to deliver orders directly to the Exchange's System.

The proposed MARS Payment schedule is not unfairly discriminatory because the Exchange will uniformly pay all Phlx members the rebates specified in the proposed MARS Payment tiers provided that the Phlx member has executed the requisite number of Eligible Contracts. Moreover, the Exchange believes that the proposed MARS Payments offered by the Exchange are equitable and not unfairly discriminatory because any qualifying Phlx member that offers market access and connectivity to the Exchange and/or utilize such functionality themselves may earn the MARS Payment for all Eligible Contracts.

Although the Exchange proposes to offer different rebates for executions of Eligible Contracts in SPY and those in other options, the Exchange does not believe that this proposal is unfairly discriminatory. SPY options are currently the most actively traded options class and the Exchange does not need to pay same rebates to incent members to route orders on SPY to the

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<sup>22</sup> The only instance in which the proposed schedule would result in member receiving a lower rebate than it does now for a given ADV would be where the member's ADV is between 27,500 and 30,000 contracts.



Exchange as it may need to pay to attract other types of options orders. Moreover, pricing by symbol is a common practice on many U.S. options exchanges.

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, the Exchange believes that the degree to which fee changes in this market may impose any burden on competition is extremely limited. In sum, if the changes proposed herein are unattractive to market participants, it is likely that the Exchange will lose market share as a result. Accordingly, the Exchange does not believe that the proposed changes will impair the ability of members or competing order execution venues to maintain their competitive standing in the financial markets.

In terms of intra-market competition, the Exchange believes that its proposed rebate schedule will be highly competitive, both with respect to SPY, which is the most actively traded options class, as well as non-SPY options. Indeed, the proposed rebates under the new schedule will in most instances be the same, if not higher, as they are under the existing schedule.

Likewise, the proposed change to the MARS eligibility criteria is pro-competitive because it will make it easier for members to qualify for the program while routing orders to venues other than Phlx.

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act.<sup>23</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

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<sup>23</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-Phlx-2017-88 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-2017-88. 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 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. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to

make available publicly. All submissions should refer to File Number SR-Phlx-2017-88 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>24</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>24</sup> 17 CFR 200.30-3(a)(12).