

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-84290; File No. SR-Phlx-2018-59)

September 26, 2018

Self-Regulatory Organizations; Nasdaq PHLX LLC; Notice of Filing of Proposed Rule Change to Amend Rules 1000, 1064, and 1069 to Allow for the Snapshot Functionality of the Floor Based Management System to be Used for All Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on September 18, 2018, Nasdaq PHLX LLC (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“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 Rules 1000, 1064, and 1069 to allow for the Snapshot functionality of the Floor Based Management System (“FBMS”) to be used for all orders.

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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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

On October 30, 2017, the Commission approved the Exchange’s proposal to establish the “Snapshot” functionality within the Floor Broker Management System (now known as the “Floor Based Management System” or “FBMS”).³ On July 17, 2018, the Commission approved another Exchange proposal to expand the availability of Snapshot to Registered Options Traders (“ROTs”) and Specialists.⁴

As set forth in Rule 1069, Snapshot allows a Floor Broker, ROT, or Specialist, at the time when they “provisionally execute”⁵ a trade in the trading crowd, to capture and record the market conditions that prevailed at the time of the provisional execution.⁶ Once a member

³ Securities Exchange Act Release No. 34-81980 (Oct. 30, 2017), 82 FR 51313 (Nov. 3, 2017) (the “Snapshot Approval Order”). As described in Exchange Rule 1063, FBMS is the electronic system that enables members to submit option orders represented or negotiated on the Exchange trading floor (the “Floor”) to the Exchange’s Trading System for execution and reporting to the consolidated tape. FBMS also facilitates the creation of an electronic audit trail for such orders.

⁴ Securities Exchange Act Release No. 34-83656 (July 17, 2018), 83 FR 34899 (July 23, 2018).

⁵ A “provisional execution” occurs in the trading crowd when either (i) the participants to a trade reach a verbal agreement in the trading crowd as to the terms of the trade, or (ii) a Floor Broker announces a cross in accordance with Phlx Rule 1064(a). See Rule 1069(a)(i)(A).

⁶ Snapshot records the time when a member triggers the functionality and the prevailing market conditions for an options class or series, which includes all information required to determine compliance with priority and trade through requirements, including the Away Best Bid and Offer, the Exchange Best Bid and Offer, customer orders at the top of the Exchange book, and the best bid and offer of all-or-none orders. See Rule 1069(a).

triggers a Snapshot by pressing a button on FBMS, the member has up to 30 seconds to use the information captured by the Snapshot for purposes of entering the terms of the provisionally-executed trade into FBMS and submitting the trade to the Trading System. After 30 seconds, a Snapshot expires and can no longer be used to capture the market that existed at the time when it was taken. When a trade that is subject to a valid Snapshot is submitted to the Trading System, the trade will execute only to the extent that it is consistent with applicable priority and trade-through rules based upon the prevailing market at the time of the Snapshot. The Trading System will reject a trade subject to a Snapshot if it would violate trade-through or priority rules. Whenever a Snapshot becomes invalid due to expiration, rejection by the Trading System, or cancellation in anticipation of expiration or rejection, a member may take a new Snapshot that reflects the market prevailing at the time the new Snapshot is taken, provided that the member first re-announces the trade to the trading crowd and reaches a new agreement as to the terms of the trade.

Snapshot exists to provide members with a means of mitigating risks that are inherent in a Floor-based options trading environment. In particular, Snapshot mitigates the risk that market conditions will shift between the time when members provisionally execute trades on the Floor in open outcry and the time when they enter such trades into FBMS and submit them to the Trading System for execution. This risk exists because, even with the advent of FBMS, which is the Exchange's electronic Floor order entry system, a member still must manually enter the terms of a trade into FBMS prior to submission to the Trading System. This manual process can take several seconds or more to complete, depending upon the complexity of the trade. The Exchange notes that this manual process is not required when trading in an all-electronic

The market conditions captured by Snapshot are derived from the same real-time market information that exists in the Trading System.

environment, such that Snapshot also serves the purpose of rendering Floor trading venues more competitive with electronic venues.

When the Exchange developed Snapshot, it made certain design choices, in coordination with the Commission, to mitigate the risk that Snapshot could be subject to overuse or abuse. For example, the Exchange limited the time period during which a Snapshot remains valid to 30 seconds. Moreover, once a Snapshot expires, a member may take a new Snapshot only after it re-announces the trade to the trading crowd and reaches a new agreement regarding its terms. Additionally, a member may have only one Snapshot outstanding across all option classes and series at a time. The Exchange also prohibits members from triggering Snapshot to obtain favorable priority or trade-through conditions or to improperly avoid unfavorable priority or trade-through conditions, and it surveils the market for proper use of Snapshot, both on a post-trade and a real-time basis.⁷

Finally, to mitigate the risk of Snapshot overuse, the Exchange initially limited its applicability only to multi-leg orders and simple orders involving options on exchange traded funds (“ETFs”) that are included in the Options Penny Pilot. The Exchange limited Snapshot to these two categories of orders because they presented the most immediately compelling use cases for Snapshot.⁸

⁷ Conduct that would constitute a violation includes repeated instances in which members permit valid Snapshots to expire without submitting associated trades to the Trading System for verification and reporting to the Consolidated Tape, as well as repeated instances in which a member waits longer than is reasonably necessary to submit a trade subject to a Snapshot to the Trading System for execution.

⁸ Snapshot Approval Order, *supra*, at 51315 (These types of orders were at “heightened risk of failing to execute when market conditions change between the time when Floor Brokers and participants in the crowd agree upon the terms of the trade and the time when the Trading System receives the trade for verification and execution.”).

Snapshot became available for use by Floor Brokers on December 4, 2017 and it recently became available to ROTs and Specialists. Since the Exchange first introduced Snapshot, it has monitored when Snapshot has been used and the frequency of such uses. Such monitoring reveals that concerns regarding the prospective misuse and abuse of Snapshot were greatly overstated. In fact, Snapshot was utilized only 24 times (21 times in executed trades, 3 times in rejected trades) over the course of eight months (December 2017-July 2018). In four of these eight months, it was not used at all. In the other four months in which Snapshot was used, it was used (successfully or otherwise) only once more than 10 times in a month and otherwise, no more than six times in a month.

To improve the competitive position of the Exchange Floor relative to other venues, the Exchange now proposes to broaden the applicability of Snapshot to all orders. The Exchange believes that this proposal will make Snapshot simpler, more consistent, and useful in more circumstances than it is now. Moreover, the Exchange believes that its experience with Snapshot demonstrates that it can accommodate this proposal while continuing to systematically enforce trade-through and priority rules and without materially raising the risk that Snapshot will be overused or abused. The existing design controls that mitigate such risks will continue to apply, and if Surveillance—which will continue monitor Snapshot usage closely—detects a significant uptick in improper usage, then the Exchange will evaluate whether additional controls are appropriate.

The Exchange expects to begin making Snapshot available for all orders before the end of the fourth quarter of 2018. The Exchange will notify members via an Options Trader Alert, to be posted on the Exchange's website, at least seven calendar days prior to the date when Snapshot will be available for expanded use.

Lastly, the Exchange proposes to remove from Rules 1000 and 1064 language that announced the initial launch of the Snapshot functionality in Q4 2017. This language is no longer required as Snapshot is operational.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act⁹ in general, and furthers the objectives of Section 6(b)(5) of the Act¹⁰ 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 to protect investors and the public interest.

Snapshot promotes just and equitable principles of trade and serves the interests of investors and the public by increasing the likelihood that investors will be able to execute their orders and do so in line with their expectations and needs. Similarly, Snapshot mitigates the risk that the Trading System will reject a trade due to a change in market conditions that occurs between the time when the parties negotiate a lawful and valid trade on the Floor and the time when the Trading System receives it. The proposal to expand the applicability of Snapshot to all orders will broaden the scope of such protections.

The expansion of Snapshot to all orders will also help Snapshot to better achieve its intended purpose of rendering the Exchange Floor more competitive with other trading venues at which the Exchange observes trade executions occurring seconds or even minutes after verifications occur, but on trading terms that existed as of the time of verification.

The Exchange believes that it is consistent with the Act to broaden the applicability of Snapshot to all option orders traded on the Exchange Floor. Although multi-leg orders and

⁹ 15 U.S.C. 78f(b).

¹⁰ 15 U.S.C. 78f(b)(5).

simple orders in options on Options Penny Pilot ETFs were perhaps the most immediately compelling use cases for Snapshot, they are by no means the only use cases for the functionality. Indeed, all options orders that are negotiated on the Exchange Floor are subject to the same risk of market movement, to varying extents, from the time of their negotiation in open outcry to the time of their submission to the Trading System. For all of these orders, Snapshot will help to mitigate this risk. Enabling members to provisionally execute all categories of options on the Floor (using Snapshot when needed), rather than execute them in the Trading System, will not adversely impact investors or the quality of the market due to the controls that the Exchange proposes on the circumstances in which members may use Snapshot. In fact, the proposal will protect investors and the public interest by improving members' ability to execute orders negotiated on the Floor while continuing to ensure that all priority and trade through rules are systematically enforced.

Moreover, this proposal is consistent with Rule 611 of Regulation NMS,¹¹ which requires the Exchange to establish policies and procedures that are reasonably designed to prevent trade-throughs of protected quotations. Presently, the Exchange verifies that a proposed trade complies with the trade-through and priority rules as of the time when the Trading System receives the trade from FBMS; if the trade complies, then the Trading System executes the trade and reports it to the consolidated tape. However, the proposal would serve as an exception to this practice. It would permit members, upon reaching a meeting of the minds in the trading crowd regarding the terms of a trade, to take a Snapshot that provisionally executes the trade on the Floor. When the member submits the trade to the Trading System using Snapshot, the Trading System will verify that the provisionally executed trade complied with the trade-through and

¹¹ 12 CFR 242.611 [sic].

priority rules as of the time of its execution – i.e., the time when the crowd agreed to the terms of the trade and Snapshot was taken – rather than at the time when the Trading System receives the trade. If the Trading System determines that the provisionally executed trade complied with the trade-through and priority rules, then it will report the trade to the Consolidated Tape. If, however, the Trading System determines that the provisionally executed trade was non-compliant with the trade-through and priority rules as of the time when the Snapshot was taken, then it will reject the trade. In other words, even though the proposal will change the time of execution of a trade for purposes of verifying compliance with the trade-through and priority rules, the automated compliance verification process will otherwise be unchanged and will still apply to systematically prevent any violation of the trade-through and priority rules for all trades, including those utilizing Snapshot.

Finally, the Exchange’s proposal accomplishes the above in a manner that: (1) continues to provide automated and verifiable enforcement of applicable trade-through and priority rules; (2) is documented in writing and transparent; (3) provides for trade reporting to occur in a timely fashion, even for the most complex trades, and within a 30 second time frame that is far less than the maximum 90 second reporting period allowable; and (4) imposes surveillance and responsible limitations upon Snapshot that ensure appropriate usage and prevents violations and abuse.

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 fact, the proposal is pro-competitive for several reasons. The Exchange believes that the Snapshot feature will result in the Exchange’s Floor operating more efficiently, which will help it compete with other floor-based exchanges.

Moreover, the proposal helps the Exchange compete by ensuring the robustness of its regulatory program, ensuring members' compliance with that program, and by enhancing Customer protections through further utilization of electronic tools by members. The Exchange considers all of these things to be differentiators in attracting participants and order flow.

Finally, the proposal does not impose an unreasonable burden on intramarket competition because the Exchange would make Snapshot available for use for all orders by all members that trade on the Options Floor.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission shall: (a) by order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be 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. Please include File Number SR-Phlx-2018-59 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-2018-59. 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-2018-59 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.¹²

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¹² 17 CFR 200.30-3(a)(12).