

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-84545; File No. SR-Phlx-2018-68)

November 6, 2018

Self-Regulatory Organizations; Nasdaq PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend the Rule 3400 Series

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 October 25, 2018, 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 Rule 3400 Series concerning the Order Audit Trail System to make conforming and technical changes.

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

¹ 15 U.S.C. 78s(b)(1).

² 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 Exchange is proposing to amend the Rule 3400 Series concerning the Order Audit Trail System to: (1) renumber the Rule 3400 Series to conform it to the numbering convention used by the Nasdaq Stock Market LLC (“Nasdaq”) and FINRA; (2) amend Rule 7410A to expand two existing exemptions and to make technical changes to text under the rule; (3) incorporate by reference FINRA Rules 7430, 7440 and 7450 in Rules 7430A, 7440A and 7450A, respectively, and make conforming changes thereto; and (4) delete Rule 3407.³

The Exchange’s Rule 3400 Series imposes an obligation on Exchange members to record in electronic form and report to FINRA on a daily basis certain information with respect to orders originated, received, transmitted, modified, canceled, or executed by members in Nasdaq- and Exchange-listed stocks. FINRA’s Order Audit Trail System (“OATS”) captures this order information and integrates it with quote and transaction information to create a time-sequenced record of orders, quotes, and transactions. This information is used by FINRA staff to conduct surveillance and investigations of members for potential violation of Exchange rules and federal securities laws.

The Exchange adopted the Rule 3400 Series to copy Nasdaq and FINRA OATS rules, where appropriate. As a general principle, the Exchange endeavors to keep its rules that are

³ The Exchange is filing a request for an exemption under Section 36 of the Act from the rule filing requirements of Section 19(b) of the Act for certain rules included in this proposal, and will implement the changes proposed herein upon approval of the exemption request.

corresponding to FINRA rules as closely worded and structured as possible to the FINRA rules on which they are based, including FINRA's OATS rules under the FINRA Rule 7000 Series. In certain instances, the Exchange has not copied a FINRA OATS rule because it is not relevant. For example, the Exchange has not copied FINRA Rule 7410(o)(2), which concerns an exception to the definition of a Reporting Member relating to members operating on equities floors, because the Exchange does not operate an equities floor. Generally, the Exchange also seeks to keep the Rule 3400 Series consistent with Nasdaq's Rule 7400A Series, the substance of which is identical to the related rules of the Exchange. The proposed changes will harmonize Exchange rules with analogous Nasdaq and FINRA rules, which have changed since the Exchange first adopted its rules.

First Change

The Exchange is proposing to renumber the Rule 3400 Series to a new Rule 7000A Series, which is identical to how Nasdaq presents its OATS rules. The Exchange does not currently have a Rule 7000A Series and the Exchange is proposing to follow the numbering convention used by FINRA and NASDAQ. As part of this change, the Exchange is also updating cross references in the Rule 7000A Series.

Second Change

The Exchange is amending renumbered Rule 7410A to make several changes to conform it to the rules of Nasdaq. The Exchange is proposing to add new text noting that the terms under the rule have the same meaning as those defined in the Exchange's By-Laws and rules, unless otherwise noted, which is identical to Nasdaq's Rule 7410A(a). The Exchange is also amending Rule 7410A to make technical changes that harmonize the definitions of "Index Arbitrage

Trade,” “Program Trade,” and “Proprietary Trading Firm” with the definitions of those terms in the Nasdaq rules.⁴

The Exchange is also proposing to adopt the same limited exemption from OATS order data recordation requirements for Exchange members that are registered market makers in standardized options on any market. Renumbered Rule 7410A(j) defines the term “Order” as any oral, written, or electronic instruction to effect a transaction in an equity security listed on the Exchange or Nasdaq that is received by a member from another person for handling or execution, or that is originated by a department of a member for execution by the same or another member, other than any such instruction to effect a proprietary transaction originated by a trading desk in the ordinary course of a member’s market making activities in an Exchange-listed equity security. The Exchange is proposing to adopt the limited exemption currently available under Nasdaq’s analogous definition of “Order,”⁵ which excludes from the definition a bona fide hedge transaction involving a Nasdaq-listed equity security originated by a trading desk in the ordinary course of the member’s options market making activities.⁶ As noted by Nasdaq in adopting the exemption, OATS was designed to provide an accurate, time-sequenced record of orders and transactions, beginning with the receipt of an equity order at the first point of contact between the broker-dealer and the customer or counterparty and further documenting

⁴ The Exchange is not adopting the definition of “NMS Stock” found under Nasdaq Rule 7410A(j). The term is not used in the Exchange’s OATS rules. In addition, the term is not used in the Nasdaq OATS rules. The term is used in FINRA Rule 7410(k) defining “Order Audit Trail System, whereas the Exchange and Nasdaq instead reference Exchange and Nasdaq listed securities under Exchange renumbered Rule 7410A(k) and Nasdaq listed securities under Nasdaq Rule 7410A(l).

⁵ See Nasdaq Rule 7410A(k).

⁶ The Exchange notes that Nasdaq capitalizes the term “Bona Fide Hedge Transaction” in Nasdaq Rule 7410A(k), although the term is not defined in Nasdaq’s rules. The Exchange believes that capitalizing the term was an error and is therefore not capitalizing the term in Rule 7410A(j).

the life of the equity order through the process of execution.⁷ The proposed rule change does not impact the customer protection orientation of OATS since, by definition, bona fide hedging transactions in equity securities that are undertaken by options market makers do not involve customer orders in those equity securities. Rather, bona fide hedging transactions in equity securities are undertaken by an options market maker to hedge against the firm risk that it creates through its conduct as a registered options market maker. Accordingly, bona fide hedge transactions do not implicate customer protection issues, and requiring reporting of such transactions would not provide a regulatory benefit. It is also very expensive for firms that are not currently FINRA members or that do not currently trade Exchange or Nasdaq equities to develop and maintain the compliance systems and compliance staff required to continuously monitor the daily transmission of OATS data. For these reasons, the Exchange is proposing to adopt such an exemption, available to its options market makers.

The Exchange is proposing to amend Rule 7410A(n)(1) to harmonize the rule with FINRA Rule 7410(o)(1)(A) and Nasdaq Rule 7410A(o)(1)(A). Rule 7410A(n) provides the definition of “Reporting Member Organization,” which means a member organization that receives or originates an order and has an obligation to record and report information under renumbered Rules 7440A and 7450A. The Rule also provides an exception to the general definition if the member organization meets four conditions. The first condition in subparagraph (n)(1), which is the only condition at issue in this proposal, is that currently the member organization engages in a non-discretionary order routing process, pursuant to which it immediately routes, by electronic or other means, all of its orders to a single receiving Reporting Member Organization. On May 12, 2014, FINRA amended FINRA Rule 7410(o)(1)(A) to allow

⁷ See Securities Exchange Act Release No. 59369 (February 6, 2009), 74 FR 7278 (February 13, 2009) (SR-NASDAQ-2008-097).

a member to satisfy this condition by permitting a member to alternatively route its orders to two receiving Reporting Members, if two related requirements were met.⁸ First, the orders must be routed by the member to each receiving Reporting Member on a pre-determined schedule approved by FINRA. Second, the orders must be routed by the member to two receiving Reporting Members pursuant to the schedule for a time period not to exceed one year. FINRA noted in adopting the change that the rule was intended to accommodate introducing firms that transition to a different clearing firm over time and, during the transition, route their orders to two different clearing firms, both of which report the introducing firm's information to OATS during the transition time. Nasdaq recently amended its rule to incorporate this change.⁹ The Exchange believes that this additional limited exception is appropriate for its member organizations, which likewise may encounter a transition to a clearing firm whereby they would no longer be eligible for the exception to the definition of Reporting Member Organization. Accordingly, the Exchange is proposing to adopt the FINRA rule text under renumbered Rule 7410A(n)(1)(B).

Third Change

The Exchange is proposing to incorporate by reference FINRA Rules 7430, 7440 and 7450 in Rules 7430A, 7440A and 7450A, respectively, and make conforming changes thereto.¹⁰ Current Rule 3403 concerns synchronization of Member Organization business clocks and is

⁸ See Securities Exchange Act Release No. 72191 (May 20, 2014), 79 FR 30219 (May 27, 2014) (SR-FINRA-2014-024).

⁹ See Securities Exchange Act Release No. 83115 (April 26, 2018), 83 FR 19384 (May 2, 2018) (SR-NASDAQ-2018-030).

¹⁰ The Exchange is proposing to add text to Rules 7440A and 7450A, which notes that Exchange and FINRA are parties to the FINRA Regulatory Contract pursuant to which FINRA has agreed to perform certain functions on behalf of the Exchange, and also notes that members are complying with Rules 7440A and 7450A by complying with FINRA Rules 7440 and 7450, respectively. Nasdaq places the same text under Nasdaq Rules 7440A(a) and 7450A(a), respectively.

substantially identical to FINRA Rule 4590(a). Nasdaq Rule 7430A requires Nasdaq members to comply with FINRA Rule 4590 as if such rule were part of Nasdaq's rules and provides that references to "the FINRA By-Laws or other FINRA rules" shall be construed as references to "the Nasdaq Rules," for purposes of Nasdaq Rule 7430A. The Exchange is proposing to conform its rule text to that of Nasdaq.¹¹

With respect to Rule 7440A, the Exchange is proposing to copy Nasdaq Rule 7440A and incorporate by reference FINRA Rule 7440. Current Rule 3404 is meant to copy FINRA Rule 7440; however, FINRA amended FINRA Rule 7440 subsequent to the Exchange adopting Rule 3404 and the Exchange did not update its rule to reflect these changes. Specifically, FINRA amended Rules 7440(a)(2),¹² (a)(4),¹³ (b)(9),¹⁴ (b)(19),¹⁵ (b)(21),¹⁶ (c)(1)(H),¹⁷ (c)(2)(A)(viii) and

¹¹ The Exchange is not including text from Nasdaq Rule 7440A(a) and 7450A(a), which notes that members are complying with these rules by complying with the related FINRA rules, in Rules 7440A(a) and 7450A(a). The Exchange believes these sentences are duplicative of the first sentence of Rules 7440A(a) and 7450A(a).

¹² See Securities Exchange Act Release No. 71623 (February 27, 2014), 79 FR 12558 (March 5, 2014) (SR-FINRA-2013-050).

¹³ See Securities Exchange Act Release No. 63784 (January 27, 2011), 76 FR 5850 (February 2, 2011) (SR-FINRA-2010-052).

¹⁴ See Securities Exchange Act Release No. 63032 (October 4, 2010), 75 FR 62439 (October 8, 2010) (SR-FINRA-2010-043).

¹⁵ See Securities Exchange Act Release No. 77523 (April 5, 2016), 81 FR 21427 (April 11, 2016) (SR-FINRA-2016-006).

¹⁶ See Securities Exchange Act Release No. 77164 (February 17, 2016), 81 FR 9043 (February 23, 2016) (SR-FINRA-2015-048).

¹⁷ See Securities Exchange Act Release No. 66021 (December 21, 2011), 76 FR 81551 (December 28, 2011) (SR-FINRA-2011-063).

(ix),¹⁸ (c)(3)(A)(ix) and (x),¹⁹ (c)(4)(A)(x) and (xi),²⁰ (c)(5)(A)(x) and (xi),²¹ (c)(6)(k) and (l),²² and (d)(4).²³ The Exchange believes that these changes are appropriate for the reasons described by FINRA when it adopted the changes, and because adopting these changes will harmonize the Exchange's rules with those of Nasdaq and FINRA. Last and consistent with Nasdaq Rule 7440A(b), the Exchange is proposing to add new Rule 7440A(c), which provides that references to certain FINRA Rules are to be construed as references to certain Rules of the Exchange. Specifically, Rule 7440A(c)(1) provides that references to Rules FINRA Rules 7420 through 7460 shall be construed as references to Rules 7420A through 7460A.²⁴ Rule 7440A(c)(2) provides that references to FINRA Rules 5320, 7440, and 7450 shall be construed as references to Rules 765, 7440A, and 7450A, respectively.

Current Rule 3405 concerns order data transmission requirements and is meant to copy FINRA Rule 7450. Unlike Nasdaq, which incorporated by reference FINRA Rule 7450 into Nasdaq Rule 7450A, the Exchange instead adopted actual rule text that copied the requirements of FINRA Rule 7450 under Rule 3405. The Exchange is proposing to adopt the approach followed by Nasdaq by incorporating by reference the FINRA rule. Specifically, the Exchange

¹⁸ See Securities Exchange Act Release No. 63032 (October 4, 2010), 75 FR 62439 (October 8, 2010) (SR-FINRA-2010-043).

¹⁹ Id.

²⁰ Id.

²¹ Id.

²² Id.

²³ See Securities Exchange Act Release No. 77164 (February 17, 2016), 81 FR 9043 (February 23, 2016) (SR-FINRA-2015-048).

²⁴ The Exchange notes that Nasdaq Rules 7440A(b)(1) and (2) do not state that certain rules referenced under Nasdaq Rule 7440A are FINRA rules. The Exchange is making it clear under Rules 7440A(c)(1) and (2) that the rules referenced under Rule 7440A are FINRA rules.

is incorporating by reference FINRA Rule 7450 into Rule 7450A, amending existing paragraphs (a) – (d) to conform them to Nasdaq’s Rule 7450A(a) – (d), and deleting paragraphs (e) and (f), which are no longer needed since the Exchange is incorporating by reference FINRA Rule 7450. The Exchange notes that FINRA amended FINRA Rule 7450 subsequent to the Exchange adopting Rule 3405; however, the Exchange did not update its rule to reflect these changes. Specifically, FINRA amended Rule 7450(b),²⁵ which concerns the method and timing of transmitting data and which is covered under Rule 3405(e). The changes made by FINRA provided greater specificity to the timing of certain reports required by the rule. The Exchange believes that the changes to FINRA Rule 7450(b) are appropriate for the reasons described by FINRA when it adopted the changes, and because adopting these changes will harmonize the Exchange’s rules with those of Nasdaq and FINRA. Last, the Exchange notes that renumbered Rule 7450A(b) requires both Proprietary Trading Firms as well as their associated persons to comply with FINRA Rule 7450 in limited circumstances, whereas Nasdaq’s Rule 7450A only requires compliance by Proprietary Trading Firms. The Exchange believes that this is an omission in the Nasdaq rule and is accordingly not adjusting the Exchange rule.

Fourth Change

The Exchange is proposing to delete current Rule 3407, which will be renumbered Rule 7470A and held in reserve. Current Rule 3407 provided an exemption from the order recording and data transmission requirements of current Rules 3404 and 3405, which are OATS rules applicable to manual orders. To qualify for the exemption, a member must have met the following criteria: (1) the member and current control affiliates and associated persons of the member have not been subject within the last five years to any final disciplinary action, and

²⁵ See note 16, supra.

within the last ten years to any disciplinary action involving fraud; (2) the member has annual revenues of less than \$2 million; (3) the member does not conduct any market making activities in equity securities listed on the Exchange; (4) the member does not execute principal transactions with its customers (with a limited exception for principal transactions executed pursuant to error corrections); and (5) the member does not conduct clearing or carrying activities for other firms. The exemption was limited to a maximum time of two years although a member was able to request an additional exemption prior to the expiration of a grant of existing exemptive relief. The exemptive authority provided by the rule permitted the Exchange to grant relief to members that meet certain criteria in situations where, for example, the reporting of order information would be unduly burdensome for the member or where temporary relief from the OATS Rules, in the form of additional time to achieve compliance, would permit the members to avoid unnecessary expense or hardship. The exemption has not been requested by any Exchange member to date and the Exchange does not believe that Exchange members are likely to need the exemption, since the vast majority of such members to which the rule applies are electronic proprietary trading firms that would not qualify for the exemption. Moreover, Nasdaq does not have an analogous rule, having eliminated similar text recently for the same reasons.²⁶ Thus, the Exchange is proposing to eliminate the rule text under Rule 3407 from its rule book, renumber the rule to Rule 7470A, and hold the rule in reserve

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,²⁷ in general, and furthers the objectives of Section 6(b)(5) of the Act,²⁸ in particular, in that it is

²⁶ Id.

²⁷ 15 U.S.C. 78f(b).

²⁸ 15 U.S.C. 78f(b)(5).

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, by harmonizing the Exchange's OATS rules with those of FINRA, on which they are based, and with those of Nasdaq, which they should largely match. Consequently, the proposed change will conform Exchange Rules to changes made to corresponding FINRA and Nasdaq rules, thus promoting consistent regulatory standards with respect to rules that FINRA enforces pursuant to its Regulatory Services Agreements with the Exchange and Nasdaq. With respect to the proposed amendment to Rule 7410A(n)(1), the exemption will provide Exchange members with the same flexibility to transition to a new clearing firm that both Nasdaq and FINRA members currently enjoy. The rule is intended to accommodate introducing firms that transition to a different clearing firm over time and, during the transition, route their orders to two different clearing firms, both of which report the introducing firm's information to OATS during the transition time. Adopting the new and amended rule text under Rule 7410A will also align the Exchange rulebook with Nasdaq's and FINRA's, thereby reducing complexity from FINRA's work under a regulatory services agreement with the Exchange.

The Exchange believes that adopting the new limited exception to the definition of "Order" is consistent with the Act because it provides a very narrow exemption from reporting transactions that are done to manage risk and facilitate options market making. Bona fide hedging transactions in equity securities that are undertaken by options market makers do not involve customer orders in those equity securities and thus do not implicate customer protection issues. Moreover, information regarding bona fide hedging transactions retained by a registered Phlx Options Market market maker is otherwise available to FINRA and Phlx Regulation

through the Exchange's electronic delivery systems, upon request. This information includes trade reporting data, including order time and sales data captured by the Exchange system.

With respect to the proposed technical corrections to the rules, the Exchange believes that these changes are consistent with the Act because they will prevent investor confusion that may be caused by including in the Rules incorrect rule citations, defunct rule text and expired exemptions

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. The proposed rule change aligns the Exchange's rules with those of Nasdaq and FINRA, which will assist FINRA in its oversight work done pursuant to a regulatory services agreement. The proposed changes also provide uniform standards with which market participants must comply. Consequently, the Exchange does not believe that the proposed changes implicate competition at all.

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 Act²⁹ and subparagraph (f)(6) of Rule 19b-4 thereunder.³⁰

²⁹ 15 U.S.C. 78s(b)(3)(A)(iii).

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 necessary or appropriate in the public interest, for the protection of investors, or 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. Please include File Number SR-Phlx-2018-68 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-2018-68. 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

³⁰ 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.

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-2018-68, 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.³¹

Eduardo A. Aleman
Assistant Secretary

³¹ 17 CFR 200.30-3(a)(12).