

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-61802; File No. SR-Phlx-2010-05)

March 30, 2010

Self-Regulatory Organizations; NASDAQ OMX PHLX, Inc.; Notice of Filing of Amendment No. 2 and Order Granting Accelerated Approval of the Proposed Rule Change, as Modified by Amendment No. 2 Thereto, Relating to Professional Orders

I. Introduction

On January 12, 2010, the NASDAQ OMX PHLX, Inc. (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder² to amend the Exchange’s priority rules to treat certain non-broker-dealers in the same manner as off-floor broker-dealers with respect to priority. The proposed rule change was published for comment in the Federal Register on February 2, 2010.³ The Exchange filed Amendment No. 1 to the proposed rule change on March 26, 2010.⁴ The Exchange filed Amendment No. 2 to the proposed rule change on March 30, 2010.⁵ This order provides notice of Amendment No. 2 and approves the proposal, as modified by Amendment No. 2, on an accelerated basis.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 61426 (January 26, 2010), 75 FR 5360 (February 2, 2010) (“Notice”).

⁴ Amendment No. 2 replaces and supersedes Amendment No. 1 in its entirety.

⁵ Amendment No. 2 adds Phlx Rule 1033(e), which provides for public customer priority in synthetic options orders in open outcry, and Options Floor Procedure Advices (“Advices”) B-6, B-11 and F-5 to the list of Phlx rules in which a Professional (as defined below) would be treated in the same manner as an off-floor broker-dealer. In Amendment No. 2, Phlx also clarifies that Professional orders may be considered customer orders subject to facilitation for purposes of Phlx Rule 1064.02, and corrects a technical error by revising the reference to Advice C-3 to Advice C-2. Phlx further states in this amendment that it would issue a notice outlining the procedures for the implementation of the proposal. Amendment No. 2 also deletes a sentence in the Purpose section of the proposal, in which the Exchange stated that Professional orders would be

II. Description of Phlx's Proposal

Phlx proposes to adopt a new term, “professional,” which would be defined in paragraph (b)(14) of Phlx Rule 1000 as a 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) (“Professional”). Under the proposal, a Professional would be treated in the same manner as an off-floor broker-dealer for purposes of certain order execution rules of the Exchange. Specifically, the orders of Professionals generally would be treated like off-floor broker-dealer orders for the purposes of Phlx Rules 1014(g), which governs, among other things, the allocation of orders and, thus, priority and parity among orders and quotations;⁶ 1033(e), concerning synthetic options orders; and 1064.02, concerning facilitation orders and firm participation guarantees;⁷ in addition to other, mostly conforming changes.⁸

Under the proposal, Professionals would participate in Phlx's allocation process on equal terms with off-floor broker-dealers – i.e., Professionals would not receive priority over broker-dealers in the allocation of orders on the Exchange. The Exchange states that the proposal would not otherwise affect non-broker-dealer individuals or entities under Phlx rules. All customer

subject to the same transactions fees as customers today; changes “may” to “will” in the parenthetical regarding the definition of “professional” for Phlx Rule 1064.02;” and changes “five days” to “five business days” in footnote 8 in the Purpose Section and the Exhibit.

⁶ An exception is made, however, with respect to all-or-none orders, which would be treated like customer orders.

⁷ Professional orders, however, would be considered customer orders subject to facilitation.

⁸ These include changes to Rule 1080.08, concerning complex orders, as well as to Advices B-6, B-11 and F-5. The Exchange is also proposing to amend Rule 1063(e) and the corresponding Advice C-2, Options Floor Broker Management System, to require Floor Brokers to record a “Professional” designator in the Floor Broker Management System. See also infra, note 10. Advice C-2 is part of the Exchange's minor rule plan. See Phlx Rule 970.

orders, including non-broker-dealer orders included in the definition of “Professional” orders, would continue to be treated equally for purposes of the Exchange’s rules concerning routing of orders and order protection.⁹ The Exchange, which currently routes only eligible customer orders, would route eligible Professional orders.

In addition, the proposal would require members to indicate whether customer orders are Professional orders.¹⁰ To comply with this requirement, member organizations would be required to review their customers’ activity on at least a quarterly basis to determine whether orders that are not for the account of a broker-dealer should be represented as customer orders or Professional orders.¹¹ The Exchange states that it intends to file a separate proposed rule change to adopt fees for professional orders.¹²

⁹ See Phlx Rules 1080(m), 1083, 1084, and 1086.

¹⁰ See Phlx Rule 1000(b)(14). The Exchange states that it intends to utilize a special order origin code for Professional orders. The Exchange also proposes to disseminate the Professional designator over its new Top of Phlx Options Plus Orders, which includes disseminated Exchange top-of-market data (including orders, quotes and trades) together with all of the data currently available on the Specialized Order Feed. See Securities Exchange Act Release No. 60877 (October 26, 2009), 74 FR 56255 (October 30, 2009)(SR-Phlx-2009-92).

¹¹ Orders for any customer that had an average of more than 390 orders per day during any month of a calendar quarter would be required to be represented as Professional orders for the next calendar quarter. Member organizations would be required to conduct a quarterly review and make any appropriate changes to the way in which they are representing orders within five business days after the end of each calendar quarter. While member organizations would only be required to review their accounts on a quarterly basis, if during a quarter the Exchange identifies a customer for which orders are being represented as customer orders but that has averaged more than 390 orders per day during a month, the Exchange would notify the member organization and the member organization would be required to change the manner in which it is representing the customer’s orders within five business days. See Notice, *supra* note 3 at 5361, n. 8.

¹² See Amendment No. 2, *supra* note 4 at 4.

III. Commission Findings and Order Granting Approval of the Proposed Rule Change Change as Modified by Amendment No. 2

After careful consideration of the proposed rule change, the Commission finds that the proposed rule change is consistent with the Act. Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)¹³ of the Act and the rules thereunder,¹⁴ and in particular with:

Section 6(b)(5) of the Act, which requires that the rules of a national securities exchange, among other things, be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest; and not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers;¹⁵ and

Section 6(b)(8) of the Act, which requires the rules of an exchange not to impose any burden on competition not necessary or appropriate in furtherance of the Act.¹⁶

Under the proposed rule change, customers who place orders on the level of frequency specified in proposed Phlx Rule 1000(b)(14) would be deemed Professionals and would no longer receive the priority treatment currently granted to all public customers. The Commission has previously approved similar proposals to give the orders of certain customers, identified as “Professional Orders”¹⁷ or “Professionals”,¹⁸ no greater priority than that given to broker-dealer

¹³ 15 U.S.C. 78f(b).

¹⁴ In approving the proposed rule change, the Commission notes that it has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁵ 15 U.S.C. 78f(b)(5).

¹⁶ 15 U.S.C. 78f(b)(8).

¹⁷ See International Securities Exchange, LLC (“ISE”) Rule 100 (a)(37C).

¹⁸ See Chicago Board Options Exchange, Incorporated (“CBOE”) Rule 1.1 (ggg).

orders.¹⁹ Under the Professional Customer Approval Orders, the orders of public customers that are deemed Professional orders are no longer accorded the priority granted to the orders of all other public customers.²⁰ While Phlx Rule 1000(b)(14) differs slightly from the rules adopted in the Professional Customer Approval Orders, the Commission believes that the Exchange's proposed rule change is comparable to rules of the ISE and CBOE, which the Commission found to be consistent with the Act.

In the ISE Approval Order, the Commission reviewed the background and history of customer order priority rules on national securities exchanges, and analyzed the role played in the shaping of these rules by various considerations and principles. In this regard, the Commission discussed the requirement of Section 6(b)(5) of the Act that the rules of an exchange be designed to protect investors and the public interest; traditional notions of customer priority in exchange trading; the agency obligations of exchange specialists; and the requirements of Section 11(a) of the Act.²¹ In approving the ISE proposal, the Commission articulated its view that priority for public customer orders is not an essential attribute of an exchange,²² and noted that in the past it has approved trading rules at options exchanges that do not give priority to orders of public customers that are priced no better than the orders of other market participants.²³

¹⁹ See Securities Exchange Act Release No. 59287 (January 23, 2009), 74 FR 5694 (January 30, 2009) (“ISE Approval Order”); 61198 (December 17, 2009), 74 FR 68880 (December 29, 2009) (“CBOE Approval Order”) (together, the “Professional Customer Approval Orders”).

²⁰ See ISE Approval Order, supra note 19 and CBOE Approval Order, supra note 19.

²¹ ISE Approval Order, supra note 16. For a brief synopsis of the requirements of Section 11(a), see infra, note 25.

²² See ISE Approval Order, supra note 19, at 5697.

²³ See ISE Approval Order, supra note 19, at 5697, n. 41-44.

In the ISE Approval Order, the Commission concluded that Section 6(b)(5) of the Act does not require an exchange to treat the orders of public customers who place orders at the frequency of more than 390 orders per day on average identically to the orders of public customers who do not meet that threshold.²⁴ For the same reason, the Commission believes that Phlx's proposed rule change is consistent with Section 6(b)(5) of the Act.

The Commission believes that its view with respect to the ISE Approval Order is equally applicable to the Phlx proposal. In this regard, the Commission does not believe that the Act requires that the orders of a public customer or any other market participant be granted priority. Historically, in developing their trading and business models, exchanges have adopted rules, with Commission approval, that grant priority to certain participants over others, in order to attract order flow or to create more competitive markets. However, the Act does not entitle any participant to priority as a right. The requirement of Section 6(b)(8) of the Act that the rules of an exchange not impose an unnecessary or inappropriate burden upon competition does not necessarily mandate that a Professional (as defined in the Phlx proposal) be granted priority at a time that a broker-dealer is not granted the same right. The Phlx proposal simply restores the treatment of persons who would be deemed Professionals to a base line where no special priority benefits are granted.²⁵ Thus, the Commission believes that it is consistent with the Act for Phlx

²⁴ See ISE Approval Order, supra note 19, at 5697. See also CBOE Approval Order, supra note 19.

²⁵ In its proposal, the Exchange addressed compliance with Section 11(a) of the Act and the rules thereunder as applied to the Exchange's electronic trading platform, Phlx XL II. Section 11(a) prohibits a member of a national securities exchange from effecting transactions on that exchange for its own account, the account of an associated person, or an account over which it or its associated person exercises discretion unless an exception applies. Section 11(a)(1) and the rules thereunder contain a number of exceptions for principal transactions by members and their associated persons, including the exceptions in subparagraph (G) of Section 11(a)(1) and in Rule 11a1-1(T), as well as Rule 11a2-2(T) under the Act. The Exchange represents that, as applied to Phlx XL II, it does not believe

to amend its rules so that Professional orders, like the orders of broker-dealers, are not granted special priority.²⁶

Pursuant to Section 19(b)(2) of the Act,²⁷ the Commission may not approve any proposed rule change, or amendment thereto, prior to the 30th day after the date of publication of notice of the filing thereof, unless the Commission finds good cause for so doing and publishes its reasons for so finding. The Commission hereby finds good cause for approving the proposed rule change, as modified by Amendment No. 2, before the 30th day after the date of publication of notice of filing thereof in the Federal Register.²⁸ The Commission notes that the proposal was published for comment in the Federal Register on February 2, 2010. The Commission did not receive any comments on the proposed rule change. The Commission does not believe that Amendment No. 2 significantly alters the proposal. In the amendment, the Exchange deleted an Exchange rule from and added several Exchange rules and Advices to the list of rules that would be affected by the proposal; identified in one instance where a specific provision of a rule would

that the proposal would affect the availability of the exceptions to Section 11(a) of the Act, including the exceptions in subparagraph (G) of Section 11(a) and in Rules 11a1-1(T) and 11a2-2(T), as are currently available. See Notice, supra note 3.

²⁶ The Commission notes that certain trading practices that could be affected by the proposed rule change may raise issues outside the scope of its review of the proposal itself. Specifically, any entity that acts as “dealer,” as defined in Section 3(a)(5) of the Act, 15 U.S.C. 78c(a)(5), is required to register with the Commission under Section 15 of the Act, 15 U.S.C. 78o, and the rules and regulations thereunder, or qualify for any exception or exemption from registration. Activity that may cause a person to be deemed a dealer includes ““quoting a market in or publishing quotes for securities (other than quotes on one side of the market on a quotations system generally available to non-broker-dealers, such as a retail screen broker for government securities).” See Definitions of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934, Securities Exchange Act Release No. 47364, 68 FR 8686, 8689, note 26 (February 24, 2003) (quoting OTC Derivatives Dealers, Securities Exchange Act Release No. 40594 (October 23, 1998), 63 FR 59362, 59370, note 61 (November 3, 1998)).

²⁷ 15 U.S.C. 78s(b)(2).

²⁸ See supra note 3.

be affected by the proposal; and made a few technical or clarifying changes to the rule text, Purpose section, and/or Exhibit to the proposed rule change. The Commission believes that these revisions are consistent with the proposal's purpose and raise no new significant issues. The amendment also indicated that the Phlx intends to file a separate proposed rule change to adopt fees for Professional orders. Finally, Phlx noted that it would issue a notice outlining the procedures for implementation of the proposal.

As noted above, the Commission previously found that exchange rules that distinguish between the orders of customers who place orders at the frequency of more than 390 orders per day on average during a calendar month for its own beneficial account(s) and the orders of customers who do not meet that threshold are consistent with the Act.²⁹ Accordingly, pursuant to Section 19(b)(2) of the Act,³⁰ the Commission finds good cause to approve the proposed rule change, as modified by Amendment No. 2, on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as modified by Amendment No. 2, 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-2010-05 on the subject line.

Paper comments:

²⁹ See Professional Customer Approval Orders, *supra* note 19.

³⁰ 15 U.S.C. 78s(b)(2).

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-Phlx-2010-05. 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,³¹ 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 Web site 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 am and 3:00 pm. 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-2010-05 and should be submitted on or before [insert date 21 days after publication in the Federal Register].

³¹ The text of the proposed rule change is available on Exchange's Web site at <http://nasdaqomxphlx.cchwallstreet.com/NASDAQOMXPHLX/Filings/>, on the Commission's Web site at <http://www.sec.gov>, at the principal office of the Exchange, and at the Commission's Public Reference Room.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,³² that the proposed rule change (SR-Phlx-2010-05), as modified by Amendment No. 2, be, and it hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³³

Florence E. Harmon
Deputy Secretary

³² 15 U.S.C. 78s(b)(2).

³³ 17 CFR 200.30-3(a)(12).