

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-63717; File No. SR-Phlx-2010-145)

January 14, 2011

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval to a Proposed Rule Change, as Modified by Amendment No. 1 Thereto, Relating to the Establishment of Remote Specialists

I. Introduction

On October 14, 2010, NASDAQ OMX PHLX LLC (“Phlx” or the “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² a proposed rule change to allow certain Phlx exchange members to act as option specialists that are not physically present on the option trading floor. The proposed rule change was published for comment in the Federal Register on November 2, 2010.³ On January 11, 2011, the Exchange filed Amendment No. 1 to the proposed rule change.⁴ The Commission received no comments on the proposal. This order provides notice of filing of Amendment No. 1 and grants accelerated approval to the proposed rule change, as modified by Amendment No. 1.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 63192 (October 27, 2010), 75 FR 67427 (“Notice”).

⁴ On December 16, 2010, the Exchange extended the period for Commission consideration of its proposal to January 14, 2011. See 15 U.S.C. 78s(b)(2)(A)(ii)(II) (concerning the ability of the self-regulatory organization that filed a proposed rule change to extend the time period for Commission consideration of its proposal).

II. Description of the Proposal

The Exchange proposes to amend Phlx Option Rules 501, 506, 507, 1014, and 1020 to provide for remote specialists under limited circumstances and amend its Option Floor Procedure Advices⁵ B-3 and E-1 to reflect the new category of remote specialist.

Currently, Phlx has several types of Registered Options Traders (“ROTs”)⁶ that can register as market makers on the Exchange, including specialists, Streaming Quote Traders (“SQTs”),⁷ and Remote Streaming Quote Traders (“RSQTs”).⁸ Specialists are floor-based Exchange members who are registered as options specialists pursuant to Rule 1020(a). An SQT has a physical presence on the options floor (though they may be “in-crowd” or “out-of-crowd”) and is authorized to generate and submit option quotations electronically in options to which such SQT is assigned, but may only do so when he or she is physically present on the floor of the Exchange. An RSQT, on the other hand, has no physical trading floor presence and instead is authorized to generate and submit option quotations electronically in options to which such RSQT has been assigned. The various market marking requirements applicable to each category of market maker are set forth in Rule 1014. Rules 500 through 599 (the “Allocation and

⁵ Phlx’s Options Floor Procedure Advices (“OFPAs” or “Advices”) are part of the Exchange’s minor rule plan (“MRP” or “Minor Rule Plan”), which consists of Advices with preset fines, pursuant to Rule 19d-1(c) under the Act (17 CFR 240.19d-1(c)). See e.g., Securities Exchange Act Release No. 50997 (January 7, 2005), 70 FR 2444 (January 13, 2005) (SR-Phlx-2003-40) (order approving the Exchange’s Options Floor Broker Management System). As this time, Phlx is not proposing to change any of the fines that are applicable under any of the Advices.

⁶ A ROT is a member who has received permission from the Exchange to trade in options for his own account. Phlx also has Directed SQTs and Directed RSQTs, which receive Directed Orders as defined in Rule 1080(l)(i)(A). Specialists may likewise receive Directed Orders. Further, Phlx rules also provide for non-streaming ROTs (“non-SQT ROT”), which can make markets in certain options on an issue-by-issue basis. See Rule 1014(b)(ii)(C).

⁷ See Rule 1014(b)(ii)(A).

⁸ See Rule 1014(b)(ii)(B).

Assignment Rules”) generally describe the process for application and appointment of specialists, SQTs and RSQTs, as well as the allocation of classes of options to them.⁹

Accordingly, while Phlx’s rules provide for remote market-making ROTs (i.e., RSQTs), they do not provide for remote specialists. Rather, Phlx’s rules currently require that each options class and series listed on the Exchange have a specialist physically present on the options floor (“floor-based specialist”).¹⁰ The Exchange notes that, historically, a floor-based specialist was required for each options class and series, consistent with the traditional model of an open outcry auction market featuring trading crowds at physical trading posts on the floor and Floor Brokers¹¹ that represent orders on the floor on behalf of others.¹² In addition to its floor-based trading environment, Phlx also operates an electronic system to execute option orders,¹³ resulting in a hybrid-model options market that combines a traditional open outcry auction market trading floor with electronic trading (the “current Phlx market”).¹⁴

The Exchange notes that it has found it to be difficult at times, if not impossible, to allocate certain option products. For example, the Exchange has found that specialists may, at times, relinquish their options privileges, when, for example, the underlying securities are

⁹ The Allocation and Assignment Rules also indicate under what circumstances new allocations may not be made. See, e.g., Supplementary Material .01 to Rule 506.

¹⁰ The Exchange states in the Notice that at least one exchange that uses a specialist system has allowed certain option series to trade without a designated lead market maker (specialist).

¹¹ See Rule 1060.

¹² See Notice, supra note 3, at 75 FR 67428.

¹³ See Rule 1080 regarding the Exchange’s electronic order, trading, and execution system.

¹⁴ The current Phlx market model combining open outcry and electronic trading is also used by other options exchanges, such as Chicago Board Options Exchange, Inc., NYSE Amex LLC and NYSE Arca, Inc. Only electronic options trading is done on other exchanges, such as the International Securities Exchange, LLC and The NASDAQ Stock Market LLC.

involved in a takeover, a merger/acquisition situation, or some type of rights offering.¹⁵ Without a floor-based specialist that is willing to retain (or accept) allocation of an option, the Exchange may not list such options pursuant to its current rules. This, in turn, may negatively impact market participants and investors to the extent that the sudden delisting of a Phlx option limits their choice of execution venues. As discussed below, Phlx's proposed rule change is intended to address the difficulty that Phlx has faced in allocating options where no floor-based specialists are willing to accept the allocation. Specifically, Phlx proposes to allow for remote specialists, as it currently does for RSQTs, in order to expand the universe of market participants that could assume the role of specialist and help ensure the listing, or continued listing, of options on Phlx.

III. Discussion

After careful review, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹⁶ Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,¹⁷ in that the proposal has been designed to promote just and equitable principles of trade, and to protect investors and the public interest.

By providing for Remote Specialists, the Commission believes that Phlx's proposal will allow it to list, or continue listing, an option in which it does not have a registered floor-based specialist. The concept of a Remote Specialist would be similar to the existing class of RSQTs,

¹⁵ See Notice, supra note 3, at 75 FR 67428.

¹⁶ In approving the proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁷ 15 U.S.C. 78f(b)(5).

and several rules that are presently applicable or unique to RSQTs would be expanded to encompass Remote Specialists. Such provisions are generally reflective of the “remote” nature of a Remote Specialist and are intended to accommodate the unique circumstances of a remote quoting specialist. However, the quoting obligations applicable to a Remote Specialist would be heightened over that which is applicable to RSQTs to reflect their status as “specialists” under Exchange rules. Accordingly, all specialists, whether floor-based or remote, would be subject to similar requirements and similar privileges. Specific details of various provisions in the Exchange’s proposed rule change are discussed further below.

Specialist Rights and Obligations

Phlx proposes to define “remote specialist” by amending Rule 1020 to state that a remote specialist is a qualified RSQT approved by the Exchange to function as a specialist in one or more options, if the Exchange determines that it cannot allocate such options to a non-remote (i.e., floor based) specialist. As provided in proposed Rule 501(f) (iii), a Remote Specialist would have all the rights and obligations of a specialist, unless Exchange rules provide otherwise. Further, Phlx proposes to underscore this principle by indicating in Rule 1020(a) that the term “specialist” includes a Remote Specialist, as defined in Rule 1020(a)(ii), that is registered pursuant to Rule 501 and that a Remote Specialist has all the rights and obligations of an options specialist on the Exchange.

Becoming a Remote Specialist

The Exchange also proposes to amend Rule 501, which generally deals with the process of applying for approval to be a specialist, to indicate that in certain circumstances RSQTs may seek to register as Remote Specialists. Specifically, the process for becoming a Remote

Specialist would be a two-step process.¹⁸ A member would first need to qualify and register as a market maker on the Exchange by becoming approved as an RSQT pursuant to Rule 507.¹⁹ Then, if the RSQT wished to become a Remote Specialist, it would need to apply separately to become a Remote Specialist pursuant to the separate process set forth in Rule 501. Proposed Rule 501(f) provides that RSQTs may submit an application to be an approved specialist unit²⁰ and the Exchange may approve such application in one or more options. Under Rule 501(f)(i), a Remote Specialist could function as a specialist in one or more options only if the Exchange determines that it cannot allocate such option(s) to a floor-based specialist.²¹

The proposed rule would require that each Remote Specialist be available and reachable at all times during trading hours for the product(s) allocated to such specialist.²² Accordingly, a Remote Specialist would be required to provide Exchange staff and members with telephonic and/or electronic communication access to such specialist and its associated staff at all times during trading hours.²³

¹⁸ Proposed Rule 507(f) would state that nothing in Rule 507 shall be construed to automatically qualify an RSQT to be a Remote Specialist on the Exchange.

¹⁹ For all RSQT application and approval criteria, see Rule 507(a)(i)(A) through (a)(i)(G).

²⁰ A “specialist unit,” including a Remote Specialist unit, may have one or more individual “specialists.”

²¹ Additionally, in light of the proposed off-floor Remote Specialist, Phlx proposes to modify Rule 506(c) to require that the Exchange’s decisions regarding allocation of specialist privileges be not only communicated in writing to floor members, but also communicated in writing to all Exchange members (both floor-based and off-floor).

²² See Proposed Rule 501(f)(ii). See also OFPA E-1 (Required Staffing of Options Floor). A Remote Specialist would be required to have a representative available during the times required by that OFPA.

²³ To the extent necessary, the Exchange represents that it would announce such communication arrangements to its members via an Options Trading Alert (“OTA”) or Options Regulatory Alert (“ORA”).

Additionally, Phlx proposes to amend Rule 501 and 506 to indicate that back-up specialist arrangements and assistant specialist requirements are not applicable to Remote Specialists.²⁴ In support of this provision, the Exchange notes its belief that the rationale for requiring designation of an assistant specialist and a back-up specialist in the floor-based context is antiquated in the context of the Exchange's electronic-based trading system, in which assigned RSQTs, in conjunction with other assigned market makers on the Exchange, are able to provide liquidity in the event of a specialist's temporary absence.²⁵ Further, a similar class of remote market makers on Phlx (RSQTs) does not have back-up personnel requirements.²⁶

Quoting Obligations and Priority

Remote Specialists would be subject to all of the obligations of a floor-based specialist on the Exchange, except where otherwise noted in the Exchange's rules.²⁷ Specifically, the Exchange proposes to amend Rule 1014(b)(ii)(D)(2) to provide that Remote Specialists in a particular option shall be responsible to quote two-sided markets in that option to the same extent as an on-floor specialists would be required to do. The Exchange further proposes to amend Rule 1014(b)(ii)(D)(1) to state that the RSQT quoting requirements are not applicable to RSQTs when they are acting in the capacity of Remote Specialist. The intent of this provision is to establish equivalent quoting requirements as between on-floor specialists and Remote Specialists.

²⁴ The Exchange also proposes to clarify in Advice E-1 that a Remote Specialist is exempt from the obligation to have personnel on the trading floor, while retaining the obligation to have a representative available telephonically.

²⁵ In addition, the Exchange notes that nearly all option issues traded on Phlx are traded on multiple exchanges. As such, the historical risk that is addressed by the assistant/backup requirement (namely, the ability of the Exchange to foster the provision of liquidity) is diminished. See Notice, supra note 3, at 75 FR 67429.

²⁶ See Notice, supra note 3, at 75 FR 67429, n.20.

²⁷ See Proposed Rule 501(f)(iii).

Currently, Rule 1014 provides that quoting obligations do not apply to RSQTs in certain types of options products and establishes an exemption for RSQTs and other market makers from the obligations set forth in Rule 1014 in certain categories of products. The Exchange proposes to add new language to indicate that these exemptions apply to RSQTs only when they are acting as RSQTs, and would not apply to RSQTs when they are functioning as Remote Specialists in particular options.

Further, the Exchange proposes to amend sub-paragraph (b)(ii)(B) of Rule 1014 to clarify that an RSQT cannot simultaneously quote both as RSQT and as Remote Specialist in a particular security. That is, if an RSQT is a Remote Specialist in a particular security, the Remote Specialist must make a market as a specialist and may not make a market as an RSQT in that particular security.²⁸ Additionally, the Exchange proposes to add Remote Specialists to Commentary .05(c)(ii) of Rule 1014 to reflect that Remote Specialists will be treated similar to RSQTs and out-of crowd SQTs for priority purposes under that Rule because they do not engage in open outcry floor trading.

In addition, Commentary .05(b) to Rule 1014 states that SQTs and RSQTs can submit orders electronically. The Exchange is amending Commentary .05(b) to provide that Remote Specialists also may submit quotes electronically. Further, Commentary .05(c)(i) provides that if a Floor Broker presents a non-electronic order in an option assigned to an RSQT or an off-floor

²⁸ As an example of the operation of the proposed rules wherein an RSQT may function as a traditional RSQT and also function as a Remote Specialist, if an RSQT is allocated two option classes as a Remote Specialist, in those two classes the Remote Specialist will have the very same quoting (market making) requirements that are currently applicable to all specialists, including continuous quoting obligations. In the remaining classes to which an RSQT is appointed, the RSQT will have the same quoting (market making) requirements that are applicable to all RSQTs. The RSQT will not be able to submit quotes or act as RSQT in the two allocated Remote Specialist classes. See Amendment No. 1 to File No. SR-Phlx-2010-145 at 15 n.29 (January 11, 2011).

SQT, such as RSQT or SQT may not participate in trades stemming from the non-electronic order unless the order is executed at the price quoted by the non-crowd RSQT or SQT at the time of execution. The Exchange proposes to include Remote Specialists in Commentary .05(c)(i) to establish priority for Remote Specialists that is coextensive with the priority afforded in that Rule to RSQTs and out-of-crowd SQTs.

The Commission believes that these provisions are appropriate to set forth equivalent obligations and standards applicable to Remote Specialists that are equivalent to the obligations and standards applicable to floor-based specialists. The Commission believes that a specialist must have an affirmative obligation to hold itself out as willing to buy and sell options for its own account on a regular or continuous basis to justify receiving unique benefits available to the specialist. The Commission believes that Phlx's rules impose such affirmative obligations on Remote Specialists that choose to operate remotely and notes that, under the proposal, Remote Specialists acting from a remote location would still be required to meet the obligations of a floor-based specialist.²⁹ Furthermore, the Commission believes that RSQTs that act as Remote Specialists where no on-floor specialists are willing to accept, or retain, an option allocation, would provide or continue to provide a market that would not otherwise exist on the Exchange, which should benefit traders, investors, and public customers making hedging and trading decisions. Further, the proposed rules clearly provide that an RSQT that becomes a Remote Specialist in a particular security must make a market in that security as a specialist and may not make a market as an RSQT in that particular security.

²⁹ See id.

OFPA and Advices

The Exchange also proposes to clarify several OFPAs regarding a Remote Specialist's off-floor electronic quoting and trading capabilities. Particularly, the Exchange is amending Advice B-3 to state that a Remote Specialist is exempted from the requirement that an ROT, including a specialist, trade a certain percentage of volume on the Exchange in person. The change reflects the fact that a Remote Specialist would not be physically present on the Exchange's trading floor and would instead submit quotes and orders remotely. Additionally, the Exchange is deleting Advice A-7 (specialist responsibilities for cancellations) and Advice A-10 (specialists trading the book) as specialists are no longer agents for the book with respect to Advice A-10, and both Advices are no longer required in light of subsequent developments in the Exchange's electronic trading and communication capabilities.³⁰

Surveillance

Finally, the Exchange represents that it has developed surveillance procedures for its auction and electronic markets and will use the surveillance procedures now in place to perform surveillance of Remote Specialists.³¹

Accelerated Approval

In Amendment No. 1, the Exchange clarifies the role of a RSQT acting in the capacities of both a RSQT and a Remote Specialist to state that when acting as a Remote Specialist in specifically allocated classes the Remote Specialist will have all the same obligations that are applicable to Specialists, including continuous quoting obligations.³² Amendment No. 1 also amended proposed Rule 501(f)(ii) to require a Remote Specialist to provide Exchange staff with

³⁰ See id. at 17.

³¹ See Notice, supra note 3, at 75 FR 67431.

³² See Amendment No. 1, supra note 28, at 15 n.29.

either telephonic or electronic communication access (as originally proposed, only telephonic access was specified). Finally, Amendment No. 1 proposes to delete (rather than amend, as originally proposed) Advices A-7 and A-10, which the Exchange believes are no longer necessary for the reasons discussed above. Because the changes proposed in Amendment No. 1 are minor changes to the proposal that do not raise material issues, the Commission finds that good cause exists, consistent with Section 19(b) of the Act,³³ for approving the proposed rule change, as modified by Amendment No. 1, prior to the thirtieth day after publication of notice of filing of Amendment No. 1 in the Federal Register.

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. 1, 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-2010-145 on the subject line.

Paper Comments:

- 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-2010-145. 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

³³ 15 U.S.C. 78s(b).

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; 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-2010-145 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,³⁴ that the proposed rule change (SR-Phlx-2010-145), as modified by Amendment No. 1, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁵

Elizabeth M. Murphy
Secretary

³⁴ 15 U.S.C. 78s(b)(2).

³⁵ 17 CFR 200.30-3(a)(12).