SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-74167; File No. SR-Phlx-2014-66)

January 28, 2015

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Adopt New Exchange Rule 1081, Solicitation Mechanism, to Introduce a New Electronic Solicitation Mechanism

I. Introduction

On October 14, 2014, NASDAQ OMX PHLX LLC ("Exchange" or "Phlx") 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 adopt new Exchange Rule 1081, Solicitation Mechanism, to introduce a new electronic solicitation mechanism pursuant to which a member can electronically submit all-or-none orders of 500 contracts or more (or, in the case of mini options, 5000 contracts or more) that the member represents as agent against contra orders that the member solicited. The proposed rule change was published for comment in the Federal Register on October 31, 2014.[3] On December 8, 2014, the Commission extended the time period in which to either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change to January 29, 2015.[4] The Commission has received no comment letters on the proposal. This order institutes proceedings under Section 19(b)(2)(B) of the Act[5] to determine whether to approve or disapprove the proposed rule change.

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 73441 (October 27, 2014), 79 FR 64862 ("Notice").

4 See Securities Exchange Act Release No. 73791 (December 8, 2014), 79 FR 73924 (December 12, 2014).

5 15 U.S.C. 78s(b)(2)(B).

II. Description of the Proposal

The Exchange proposes to adopt new Rule 1081, Solicitation Mechanism, to introduce a new electronic solicitation mechanism pursuant to which a member can electronically submit all-or-none orders of 500 contracts or more (or, in the case of mini options, 5000 contracts or more) that the member represents as agent against contra orders that the member solicited. Currently, under Phlx Rule 1080(c)(ii)(C)(2), Order Entry Firms[6] must expose orders they represent as agent for at least one second before such orders may be automatically executed, in whole or in part, against orders solicited from members and non-member broker-dealers to transact with such orders.[7] The proposed rule change would provide an alternative method, enabling a member to electronically execute orders it represents on behalf of a public customer, broker-dealer, or any other entity (an "Agency Order")[8] against solicited limit orders of a public customer, broker-dealer, or any other entity (a "Solicited Order") through a solicitation mechanism designed for this purpose.[9]

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6 Rule 1080(c)(ii)(A)(1) defines "Order Entry Firm" as a member organization of the Exchange that is able to route orders to AUTOM. (AUTOM is the Exchange's electronic quoting and trading system, which has been denoted in Exchange rules as XL II, XL and AUTOM.)

7 Section (c), Solicited Orders, of Rule 1064, Crossing, Facilitation and Solicited Orders, governs execution of solicited orders by open outcry, on the Exchange trading floor, and is unaffected by proposed Rule 1081. The Exchange states that many aspects of the functionality of the proposed solicitation mechanism are similar to those provided for in Rule 1080(n), PIXL, and certain of the proposed rules track the existing PIXL rules.

8 Rule 1080(b)(i)(A) provides in part that "[f]or purposes of Exchange options trading, an agency order is any order entered on behalf of a public customer, and does not include any order entered for the account of a broker-dealer, or any account in which a broker-dealer or an associated person of a broker-dealer has any direct or indirect interest." According to the Exchange, that provision did not contemplate, and is not applicable to, the capitalized and defined term "Agency Order" as used in proposed Rule 1081.

9 The Exchange states that participants must ensure that their records adequately demonstrate the solicitation of an order that is entered into the mechanism for execution.

The new mechanism is a process by which a member (the "Initiating Member") can electronically submit all-or-none orders[10] of 500 contracts or more (or, in the case of mini options,[11] 5000 contracts or more) that it represents as agent against contra orders that it has solicited, and initiate an auction (the "Solicitation Auction").[12] As noted below, at the end of the Solicitation Auction, allocation would occur with all contracts of the Agency Order trading at an improved price against non-solicited contra-side interest or at the stop price, defined below, against the Solicited Order. The solicitation mechanism would accommodate both simple orders and Complex Orders.[13] Prior to the first time a member enters an Agency Order into the solicitation mechanism on behalf of a customer, the member would be required to deliver to the customer a written notification informing the customer that its Agency Orders may be executed using the Phlx's solicitation mechanism. Such written notification would be required to disclose

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against an Agency Order as a Solicited Order prior to entry of such order into this mechanism.

10 Rule 1066(c)(4) defines an "all-or-none" order as a market or limit order which is to be executed in its entirety or not at all.

11 A given Solicitation Auction may be for options contracts exclusively or for mini options contracts exclusively, but cannot be used for a combination of both options contracts and mini options contracts together.

12 The Exchange noted that similar electronic functionality is offered today by other option exchanges. See Chicago Board Options Exchange ("CBOE") Rule 6.74B, Solicitation Auction Mechanism (the "CBOE Mechanism"), and International Securities Exchange ("ISE") Rule 716(e), Solicited Order Mechanism (the "ISE Mechanism").

13 A Complex Order is any order involving the simultaneous purchase and/or sale of two or more different options series in the same underlying security, priced at a net debit or credit based on the relative prices of the individual components, for the same account, for the purpose of executing a particular investment strategy. A Complex Order may also be a stock-option order, which is an order to buy or sell a stated number of units of an underlying stock or exchange-traded fund ("ETF") coupled with the purchase or sale of options contract(s). Complex Orders on Phlx are discussed in Commentary .08 to Rule 1080.

the terms and conditions contained in proposed Rule 1081 and to be in a form approved by the Exchange.[14]

Solicitation Auction Eligibility Requirements

All options traded on the Exchange, including mini options, would be eligible for the Solicitation Auction. Proposed Rule 1081(i) describes the circumstances under which an Initiating Member may initiate a Solicitation Auction.

Proposed Rule 1081(i)(A) provides that the Agency Order and the Solicited Order must each be limit orders for at least 500 contracts (or, in the case of mini options, at least 5000 contracts) and must be designated as all-or-none. The orders must match in size, and their limit prices must match or cross in price.[15] If the orders cross in price, the price at which the Agency Order and the Solicited Order may be considered for submission pursuant to proposed Rules 1081(i)(B) and (C) shall be the limit price of the Solicited Order.[16] The orders may not be stop or stop limit orders, must be marked with a time in force of day, good till cancelled or immediate or cancel, and would not be routed regardless of routing strategy indicated on the order.[17]

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14 See proposed Rule 1081(i)(H). The rule would require delivery of this disclosure only prior to the first submission of an Agency Order on behalf of a customer rather than prior to the submission of each and every Agency Order on behalf of such customer.

15 In the case of Complex Orders, the underlying components of both Complex Orders must also match. Additionally, all the option legs of each Complex Order must consist entirely of options or entirely of mini options.

16 For example, assume an Agency Order to buy 1000 contracts for $2.00 and a Solicited Order to sell 1000 contracts at $1.90 are entered into the solicitation mechanism. Since the limits of these orders cross in price, the Agency Order and Solicited Order are considered to be submitted into the mechanism with a stop price equal to the Solicited Order price of $1.90.

17 Whether an order is marked with a time in force of day as opposed to, for example, good till cancelled or immediate or cancel is irrelevant to the manner in which they would be treated once they are entered into the solicitation mechanism.

Pursuant to proposed Rule 1081(i)(B), the Initiating Member must stop the entire Agency Order at a price (the "stop price") that is equal to or better than the National Best Bid/Offer ("NBBO") on both sides of the market, provided that such price must be at least $0.01 better than any public customer non-contingent limit order on the Phlx order book and must be equal to the Agency Order's limit price or provide the Agency Order with a better price than its limit price. Stop prices may be submitted in $0.01 increments, regardless of the applicable Minimum Price Variation (the "MPV"). Contingent orders[18] (including all-or-none, stop or stop-limit orders) on the book would not be considered when checking the acceptability of the stop price. Contingent orders are not represented as part of the Exchange Best Bid/Offer since they may only be executed if specific conditions are met. Given that these orders are not represented as part of the Exchange Best Bid/Offer, they are not included in the NBBO and thus are not considered when checking the acceptability of the stop price.[19]

Orders that are submitted but that do not comply with the eligibility requirements set forth in proposed Rule 1081(i)(A) through (C) would be rejected upon receipt and ineligible to

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18 A contingent order is a limit or market order to buy or sell that is contingent upon a condition being satisfied. PIXL also does not consider contingent orders on the book when checking the acceptability of the stop price.

19 Proposed Rule 1081(i)(B) does not apply if the Agency Order is a Complex Order (a "Complex Agency Order"). Rather, proposed Rule 1081(i)(C) applies to Complex Agency Orders and requires them to be of a conforming ratio, as defined in Commentary.08(a)(ix) to Rule 1080. A Complex Agency Order which is not of a conforming ratio would be rejected. Proposed Rule 1081(i)(C) requires all component option legs of the order to be for at least 500 contracts (or, in the case of mini options, at least 5000 contracts). It also provides that the Initiating Member must stop the entire Complex Agency Order at a price that is better by at least $0.01 than the best net price (debit or credit) (i) available on the Complex Order book regardless of the Complex Order book size; and (ii) achievable from the best Phlx bids and offers for the individual options (an "improved net price") regardless of size, provided in either case that such price is equal to or better than the Complex Agency Order's limit price. Stop prices for Complex Agency Orders may be submitted in $0.01 increments, regardless of MPV, and contingent orders on the book would not be considered when checking the acceptability of the stop price. See proposed Rule 1081(i)(C).

initiate a Solicitation Auction.[20] In addition, Agency Orders submitted at or before the opening of trading are not eligible to initiate a Solicitation Auction and would be rejected.[21] Orders submitted during a specified period of time, as determined by the Exchange and communicated to Exchange membership on the Exchange's website, prior to the end of the trading session in the affected series[22] (including, in the case of Complex Orders, in any series which is a component of the Complex Order) are not eligible to initiate a Solicitation Auction and would be rejected.[23] Agency Orders which are not Complex Orders received while another electronic auction (including any Solicitation Auction, PIXL auction, or any other kind of auction) involving the same option series is in progress would not be eligible to initiate a Solicitation Auction and would be rejected.[24] Similarly, a Complex Agency Order received while another auction in the same Complex Order strategy is in progress is not eligible to initiate a Solicitation Auction and would be rejected.[25]

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20 See proposed Rule 1081(i)(D).

21 See proposed Rule 1081(i)(E).

22 The term "series" of options means all option contracts of the same class having the same expiration date and exercise price. A "class" of options means all option contracts of the same "type" of option covering the same underlying stock. A "type" of option means the classification of an option contract as a put or a call. See Rule 1000, Applicability, Definitions and References.

23 See proposed Rule 1081(i)(F).

24 A similar restriction applies with respect to PIXL auctions. See PIXL Rule 1080(n)(ii) which provides that "[o]nly one Auction may be conducted at a time in any given series or strategy."

25 However, a simple Agency Order in one series that is submitted while an electronic auction is already in process with respect to a Complex Agency Order that includes the same series would not be rejected. Instead, a Solicitation Auction would be initiated for that incoming Agency Order offering each unique strategy or individual series the same opportunity to initiate an auction. This behavior is consistent with the handling of overlapping PIXL and Complex PIXL auctions. See PIXL Rule 1080(n)(ii). Complex Orders submitted during normal trading hours in a strategy which has not yet opened under Commentary .08 of Rule 1080 would cause the strategy to immediately open and a

Finally a solicited order for the account of any Exchange specialist, streaming quote trader ("SQT"), remote streaming quote trader ("RSQT") or non-streaming registered options trader ("ROT") assigned in the affected series may not be a Solicited Order.[26] Consistent with the explanation the Exchange made in its filing proposing PIXL, the Exchange believes that in order to maintain fair and orderly markets, a market maker assigned in an option should not be solicited for participation in a Solicitation Auction by an Initiating Member. The Exchange believes that market makers interested in participating in transactions on the Exchange should do so by way of his/her quotations, and should respond to Solicitation Auction notifications rather than create them by having an Initiating Member submitting Solicited Orders on the market maker's behalf.

Solicitation Auction Process

Pursuant to proposed Rule 1081(ii)(A)(1), to begin the process the Initiating Member must mark the Agency Order and the Solicited Order for Solicitation Auction processing, and

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Solicitation Auction may be initiated. See proposed Rule 1081(i)(E). In addition, neither a Solicitation Auction for a simple Agency Order or Complex Agency Order may be initiated prior to the regular opening of all individual components of the Solicited simple or Complex Agency Order.

[26] See proposed Rule 1081(i)(G). An SQT is an Exchange Registered Options Trader ("ROT") who has received permission from the Exchange to generate and submit option quotations electronically through AUTOM in eligible options to which such SQT is assigned. An SQT may only submit such quotations while such SQT is physically present on the floor of the Exchange. See Rule 1014(b)(ii)(A). A RSQT is defined in Rule 1014(b)(ii)(B) as an ROT that is a member affiliated with a Remote Streaming Quote Trader Organization ("RSQTO") with no physical trading floor presence who has received permission from the Exchange to generate and submit option quotations electronically in options to which such RSQT has been assigned. A qualified RSQT may function as a Remote Specialist upon Exchange approval. An RSQT may only submit such quotations electronically from off the floor of the Exchange. An RSQT may not submit option quotations in eligible options to which such RSQT is assigned to the extent that the RSQT is also approved as a Remote Specialist in the same options. An RSQT may only trade in a market making capacity in classes of options in which he is assigned or approved as a Remote Specialist. An RSQTO is a member organization in good standing that satisfies the SQTO readiness requirements in Rule 507(a).

specify the stop price at which it seeks to cross the Agency Order with the Solicited Order. Once the Initiating Member has submitted an Agency Order and Solicited Order for processing pursuant to this subparagraph, such Agency Order and Solicited Order may not be modified or cancelled.[27]

Crossing Two Public Customer Orders without a Solicitation Auction

As noted above, the proposed rule change would enable a member to electronically execute an Agency Order, which is an order it represents on behalf of a public customer, broker-dealer, or any other entity, against a Solicited Order, which is a solicited limit order of a public customer, broker-dealer, or any other entity through the solicitation mechanism.

However, pursuant to proposed Rule 1081(v), if a member enters an Agency Order for the account of a public customer paired with a Solicited Order for the account of public customer and if the paired orders adhere to the eligibility requirements of proposed Rule 1081(i), such paired orders would be automatically executed without a Solicitation Auction.[28] The execution price for such paired public customer orders (except if they are Complex Orders) must be

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27 For clarity, Rule 1080(ii)(A)(l) does not apply to Complex Agency Orders. Rather, in a parallel provision, proposed Rule 1081(ii)(A)(2) provides that to initiate a Solicitation Auction in the case of a Complex Agency Order and Complex Solicited Order (a "Complex Solicitation Auction"), the Initiating Member must mark the orders for Solicitation Auction processing, and specify the price ("stop price") at which it seeks to cross the Complex Agency Order with the Complex Solicited Order. Once the Initiating Member has submitted the orders for processing pursuant to proposed Rule 1081(ii)(A)(1)-(2), they may not be modified or cancelled.

28 The eligibility requirements require the orders to each be limit orders for at least 500 contracts (or, in the case of mini options, at least 5000 contracts) and be designated as all-or-none. The orders must match in size, and the limit prices must match or cross in price. The orders may not be stop or stop limit orders, must be marked with a time in force of day, good till cancelled or immediate or cancel. In the case of Complex Orders, the orders must be of a conforming ratio, and all component option legs of the order must be for at least 500 contracts (or, in the case of mini options, at least 5000 contracts). See proposed Rule 1081(i). The Exchange also accommodates the crossing of two public customer orders in PIXL. See Rule 1080(n).

expressed in the minimum quoting increment applicable to the affected series.[29] Such an execution may not trade through the NBBO or at the same price as any resting public customer order. If all-or-none orders are on the order book in the affected series, the public customer-to-public customer order may not be executed at a price at which the all-or-none order would be eligible to trade based on its limit price and size.[30]

In the case of a Complex Order, a public customer-to-public customer cross may only occur at a price which improves the calculated Phlx Best Bid/Offer or "cPBBO" and improves upon the net limit price of any Complex Orders (excluding all-or-none) on the Complex Order book in the same strategy.[31] If all-or-none Complex Orders[32] are on the Complex Order book in the same strategy, the public customer-to-public customer Complex Order may not be executed

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29 The execution price for a Complex Order may be in $.01 increments.

30 All-or-none orders can only be submitted for non-broker-dealer customers. As stated above, all-or-none orders are not considered when checking the acceptability of the stop price of an Agency Order.

31 The term "cPBBO" means the best net debit or credit price for a Complex Order Strategy based on the PBBO for the individual options components of such Complex Order Strategy, and, where the underlying security is a component of the Complex Order, the National Best Bid and/or Offer for the underlying security. See Rule 1080.08(a)(iv).

32 The Exchange's trading system is capable of accepting all-or-none Complex Orders which are not, however, affirmatively permitted to be submitted under Exchange rules. Rule 1080.08 (b)(v) provides in part that "Complex Orders may be submitted as: All-or-none orders - to be executed in its entirety or not at all." See Securities Exchange Act Release No. 72351 (June 9, 2014), 79 FR 33977 (June 13, 2014) (SR-Phlx-2014- 39). Nevertheless, all-or-none Complex Orders may not be submitted at this time. The Exchange anticipates that it will file a proposed rule change to provide for the handling and execution of all-or-none Complex Orders and thereafter permit the trading system to accept them. The instant proposed rule change describes how the solicitation mechanism would deal with all-or-none Complex Orders once they are permitted under Exchange rules. Complex Agency Orders and Complex Solicited Orders provided for herein are not Complex Orders that would require filing of a proposed rule change in order to be submitted into the system. Complex Agency Orders and Complex Solicited Orders, while all-or-none in character, are unique to the solicitation mechanism and are explicitly provided for herein.

at a price at which the all-or-none Complex Order would be eligible to trade based on its limit price and size.

The Exchange believes that permitting such executions would benefit public customers on both sides of the crossing transaction by providing speedy and efficient executions to public customer orders in this circumstance while maintaining the priority of public customer interest on the book. The proposed handling of a public customer Agency Order paired with a public customer Solicited Order is similar to the handling of a public customer PIXL Order paired with a public customer Initiating Order which is submitted into the PIXL mechanism.[33]

Solicitation Auction Notification

Pursuant to proposed Rule 1081(ii)(A)(3), when the Exchange receives an order for Solicitation Auction processing, a Request for Response with the option details (meaning, the security, strike price, and expiration date), size and stop price, but not the side[34] of the Agency Order and the Solicitation Auction start time is then sent over the PHLX Orders data feed[35] and Specialized Quote Feed ("SQF").[36] The Exchange believes that providing option details, size,

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33 See Rule 1080(n)(vi).

34 The Exchange states that, by omitting the side in the Request for Response, the system avoids disclosure of potentially material information that could move the market in the event the Agency Order does not trade at the conclusion of the Solicitation Auction. Market participants may enter Responses on both sides of the market.

35 The PHLX Orders data feed is designed to provide the real-time status of simple and Complex Orders on the Phlx order book directly to subscribers. This includes new orders and changes to orders resting on the Phlx book for all Phlx listed options. PHLX Orders also includes opening imbalance information, PIXL information and Complex Order Live Auction ("COLA") data.

36 SQF is an interface that allows specialists and market makers to connect and send quotes into Phlx XL and assists them in responding to auctions and providing liquidity to the market.

and stop price is sufficient information for participants to determine whether to submit responses to the Solicitation Auction.[37]

Solicitation Auction

The Solicitation Auction process is described in proposed Rules 1081(ii)(A)(4) – (10). Following the issuance of the Request for Response, the Solicitation Auction would last for a period of 500 milliseconds[38] unless it is concluded as the result of any of the circumstances described below.[39]

Any person or entity may submit Responses to the Request for Response, provided such Response is properly marked specifying the price, size and side of the market at which it would be willing to participate in the execution of the Agency Order. The Exchange believes that permitting any person or entity to submit Responses to the Request for Response should attract Responses from all sources, maximizing the potential for liquidity in the Solicitation Auction and

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37 CBOE Rule 6.74B(b)(1)(B) suggests that Agency Orders submitted to CBOE's Solicitation Auction Mechanism include the proposed price at which an Agency Order is to be crossed with a solicited order, as well as the size of the order. According to Phlx, the rule does not specify that the side is to be indicated on the order. See also C2 Rule 6.52(b)(1)(B), which is similar.

38 In April/May 2014, to determine whether the proposed Solicitation Auction timer would provide sufficient time to respond to a Request for Response, the Exchange polled all Phlx market makers, 20 of which responded. Of those that responded to the survey, 15 are currently responding to auctions on Phlx or intend to do so. 100% of those respondents indicated that their firm could respond to auctions with a duration of at least 50 milliseconds. Thus, the Exchange believes that the proposed Solicitation Auction duration of 500 milliseconds would provide a meaningful opportunity for participants on Phlx to respond to a Solicitation Auction, whether initiated by an Agency Order or a Complex Agency Order, while at the same time facilitating the prompt execution of orders. The Exchange notes that both ISE and Miami International Securities Exchange LLC ("MIAX") rules provide for a 500 millisecond response time. See ISE Rule 716, Supplementary Material .04 and MIAX Rule 515A(b)(2)(i)(C).

39 Rule 1080(c)(ii)(C)(2), which states that Order Entry Firms must expose orders they represent as agent for at least one second before such orders may be automatically executed against solicited orders, is being amended to clarify that it does not apply to proposed Rule 1081, Solicitation Mechanism. See also proposed Rule 1081(ii)(A)(4).

thus affording the Agency Order the best opportunity for price improvement. Responses would not be visible to Solicitation Auction participants, and would not be disseminated to the Options Price Reporting Authority ("OPRA"). A Response may be for any size up to the size of the Agency Order.[40] The minimum price increment for Responses would be $0.01. A Response must be equal to or better than the NBBO on both sides of the market at the time of receipt of the Response. A Response with a price that is outside the NBBO at the time of receipt would be rejected.[41] Multiple Responses from the same member may be submitted at different prices on either or both sides of the market during the Solicitation Auction. Responses may be modified or cancelled during the Solicitation Auction. The acceptance and handling of Responses to a Solicitation Auction is the same as the acceptance and handling of Responses today for a PIXL Auction.[42]

Conclusion of the Solicitation Auction

Proposed Rules 1081(ii)(B)(1)-(4) describe a number of circumstances that would cause the Solicitation Auction to conclude. Generally, it would conclude at the end of the Solicitation Auction period, except that it may conclude earlier: (i) any time the Phlx Best Bid/Offer ("PBBO") on the same side of the market as the Agency Order crosses the stop price (since further price improvement would be unlikely and any Responses offering improvement would be

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40 Responses may not be submitted with an all-or-none contingency. (Note, however, that all-or-none orders entered and present in the system at the end of the Solicitation Auction would be considered for execution, as discussed below.)

41 Similarly, in the case of Complex Order Responses, the Response must be equal to or better than the cPBBO on both sides, as defined in Commentary .08(a)(iv) of Rule 1080 at the time of receipt of the Complex Order Response but need not improve upon the limit of orders on the CBOOK. A Complex Order Response submitted with a price that is outside the cPBBO at the time of receipt would be rejected. See proposed Rule 1081(ii)(A)(9).

42 See Rule 1080(n).

likely to be cancelled),[43] or (ii) any time there is a trading halt on the Exchange in the affected series (or, in the case of a Complex Solicitation Auction, any time there is a trading halt on the Exchange in any component of a Complex Agency Order).[44]

Pursuant to proposed Rule 1081(ii)(C), if the Solicitation Auction concludes before the expiration of the Solicitation Auction period as the result of the PBBO, cPBBO or Complex Order book (excluding all-or-none Complex Orders) crossing the stop price as described in proposed Rules 1081(ii)(B)(2) and 1081(ii)(B)(3), the entire Agency Order would be executed using the allocation algorithm set forth in proposed Rule 1081(ii)(E). The algorithm is described below under the heading "Order Allocation".

Also pursuant to proposed Rule 1081(ii)(C), if the Solicitation Auction concludes before the expiration of the Solicitation Auction period as the result of a trading halt, the entire Agency Order or Complex Agency Order would be executed solely against the Solicited Order or Complex Solicited Order at the stop price and any unexecuted Responses would be cancelled.[45] Responses and other interest present in the system would not be considered for trading against the Agency Order in the case of a trading halt. The Exchange believes that this is appropriate

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43 In the case of a Complex Solicitation Auction, it would end any time the cPBBO or the Complex Order book, excluding all-or-none Complex Orders, on the same side of the market as the Complex Agency Order, crosses the stop price. See proposed Rule 1081(ii)(B)(3).

44 Trading on the Exchange in any option contract is halted whenever trading in the underlying security has been paused or halted by the primary listing market. See Rule 1047(e). See also Securities Exchange Act Release No. 62269 (June 10, 2010), 75 FR 34491 (June 17, 2010) (SR-Phlx-2010-82). Any executions that occur during any latency between the pause or halt in the underlying security and the processing of the halt on the Exchange are nullified pursuant to Rule 1092(c)(iv)(B).

45 The Exchange's PIXL auction features similar functionality. Pursuant to Rule 1080(n)(ii)(C), in the case of a trading halt on the Exchange in the affected series, a PIXL Order will be executed solely against the Initiating Order at the stop price and any unexecuted PAN responses will be cancelled.

since the participants representing tradable interest in the Solicitation Auction have not 'stopped' the Agency Order in its entirety and would have no means after the auction executions occur to offset the trading risk they would incur because the market is halted if they were permitted to execute against the Agency Order in this instance. However, the Solicited Order 'stopped' the Agency Order when the order was submitted into the Solicitation Auction and would therefore execute against the Agency Order if the Solicitation Auction concludes before the expiration of the Solicitation Auction period as the result of a trading halt.

Furthermore, when Agency and Solicited Orders are submitted into the Solicitation Auction, the stop price must be equal to or improve the NBBO and be at least $0.01 better than any public customer non-contingent limit orders on the Phlx order book. The Exchange believes that public customer interest submitted to Phlx after submission of the Agency and Solicited Orders but prior to the trading halt should not prevent the Agency Order from being executed at the stop price since such public customer interest was not present at the time the Agency Order was 'stopped' by the Solicited Order.

Entry of an unrelated market or marketable limit order on the opposite side of the market from the Agency Order received during the Solicitation Auction would not cause the Solicitation Auction to end early. Rather, the unrelated order would execute against interest outside the Solicitation Auction (if marketable against the PBBO) or would post to the book and then route if eligible for routing (in the case of an order marketable against the NBBO but not against the PBBO), pursuant to proposed Rule 1081(ii)(D). If contracts remain from such unrelated order at the time the Solicitation Auction ends, the total unexecuted volume of such unrelated interest would be considered for participation in the order allocation process, regardless of the number of

contracts in relation to the Solicitation Auction size, described in proposed Rule 1081(ii)(E).[46] The handling of unrelated opposite side interest which is received during the Solicitation Auction is the same as the handling of unrelated opposite side interest which is received during a PIXL Auction.[47] Participants submitting such unrelated interest may not be aware that an auction is in progress and should therefore be able to access firm quotes that comprise the NBBO without delay. Considering such unrelated interest which remains unexecuted upon receipt for participation in the order allocation process described in proposed Rule 1081(ii)(E) would increase the number of contracts against which an Agency Order could be executed, and should therefore create more opportunities for the Agency Order to be executed at better prices.

Order Allocation

The allocation of orders executed upon the conclusion of a Solicitation Auction would depend upon whether the Solicitation Auction has yielded sufficient improving interest to improve the price of the entire Agency Order. As noted above, all contracts of the Agency Order would trade at an improved price against non-solicited contra-side interest or, in the event of insufficient improving interest to improve the price of the entire Agency Order, at the stop price against the Solicited Order.

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46 Similarly, pursuant to proposed Rule 1081(ii)(D), in the case of a Complex Solicitation Auction, an unrelated market or marketable limit Complex Order on the opposite side of the market from the Complex Agency Order as well as orders for the individual components of the unrelated Complex Order received during the Complex Solicitation Auction would not cause the Complex Solicitation Auction to end early and would execute against interest outside of the Complex Solicitation Auction. If contracts remain from such unrelated Complex Order at the time the Complex Solicitation Auction ends, the total unexecuted volume of such unrelated interest would be considered for participation in the order allocation process, regardless of the number of contracts in relation to the Complex Solicitation Auction size, described in proposed Rule 1081(ii)(E).

47 See Rule 1080(n)(ii)(D).

Consideration of All-or-None Interest. All-or-none interest of a size which could potentially be executed consistent with its all-or-none contingency is considered when determining whether there is sufficient size to execute Agency Orders which are not Complex Agency Orders at price(s) better than the stop price. However, pursuant to proposed Rule 1081(ii)(E)(5), when determining if there is sufficient size to execute Complex Agency Orders at a price(s) better than the stop price, no all-or-none interest of any size would be considered. If there is sufficient size to execute the entire Complex Agency Order at a price(s) better than the stop price irrespective of any all-or-none interest that may be present, then all-or-none interest would be considered for trade and executed if possible. This difference in behavior is due to a system limitation relating to all-or-none Complex Orders.[48] The Exchange believes this behavior is not impactful since all-or-none Complex Orders are rare[49] and if sufficient size exists to execute the entire Complex Agency Order at an improved price, the all-or-none Complex Order would be considered for trade and executed if possible.

In all Solicitation Auctions, all-or-none interest would be executed pursuant to normal priority rules, except that it would not be executed if the all-or-none contingency cannot be satisfied. If an execution which can adhere to the all-or-none contingency is not possible, such all-or-none interest would be ignored and would remain on the order book or be cancelled if such interest is an immediate or cancel order.

For example, assume an Agency Order to buy 1000 contracts stopped by a Solicited Order at $2.00 is entered when the PBBO is $1.90 - $2.10. Assume that during the Solicitation

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48 All-or-none simple orders reside with simple orders on the book. By contrast, all-or-none Complex Orders reside in a separate book, in a different part of the trading system. Thus aggregation of all-or-none Complex Orders with other Complex Orders is a more difficult process than aggregation of all-or-none simple orders with other simple orders.

49 The Exchange reviewed six months of data which showed that all-or-none Complex Orders represented only 0.12% of all Complex Orders.

Auction, Responses are received to sell 700 contracts at $1.97 and sell 150 contracts at $1.99. In addition, assume an order to sell 300 contracts at $1.98 with an all-or-none contingency is received. At the end of the Solicitation Auction, the system would consider the all-or-none order when determining if there is sufficient size to execute the Agency Order at a price(s) better than the stop price since the all-or-none contingency can be satisfied by an execution. In this example, at the end of the Solicitation Auction, the Agency Order would execute against improving interest with 700 contracts executing at $1.97 and 300 contracts (representing the all-or-none order) executing at $1.98. Consider a similar scenario whereby the Responses received were to sell 700 contracts at $1.97 and sell 300 contracts at $1.99 and an all-or-none order to sell 500 contracts at $1.98 was received. In this scenario, the system would not consider the all-or-none order when determining if there is sufficient size to execute the Agency Order at a price(s) better than the stop price since the all-or-or none contingency cannot be satisfied by an execution. However, excluding the all-or-none order, the Agency Order can still be satisfied at a price(s) better than the stop price. In this scenario, at the end of the Solicitation Auction, the Agency Order would execute against improving interest with 700 contracts executing at $1.97 and 300 contracts executing at $1.99. The 500 contract all-or-none order does not execute because the all-or-none contingency cannot be satisfied.

Similarly, assume a Complex Agency Order to buy 1000 contracts stopped by a Complex Solicited Order at $2.00 is entered when the cPBBO is $1.90 – $2.10. Assume that during the Solicitation Auction a Response is received to sell 900 contracts at $1.98 and an all-or-none Complex Order is received to sell 150 contracts at $1.99. At the end of the Solicitation Auction involving a Complex Order, the system does not consider all-or-none interest in determining whether it can execute the Complex Agency Order at a better price than the stop price. In this

case, excluding the all-or-none Complex Order, only 900 contracts are available to sell at a better price than the stop price. Therefore, the Complex Agency Order would trade against the Solicited Order at the $2.00 stop price. The all-or-none contracts would not be included because although more than 1000 contracts are offered at a better price than the $2.00 stop price, the system cannot both trade best prices first and adhere to the contingency of the all-or-none order while ensuring that the Agency Order trades 1000 contracts. If, however, the example is changed and Responses are received to sell 900 contracts at $1.98 and sell 100 contracts at $1.99 and an order to sell 100 contracts at $1.98 all-or-none is received, at the end of the Solicitation Auction involving this Complex Order, there is enough interest which is not all-or-none to satisfy the Complex Agency Order at a better price than the $2.00 stop price. Therefore, the Agency Order would be executed against the 900 lot at $1.98 and the remaining 100 contracts executed against the all-or-none Complex Order at $1.98.

Solicitation Auction with Sufficient Improving Interest. Pursuant to the proposed Rule 1081(ii)(E)(1) algorithm, if there is sufficient size (considering all resting orders, quotes and Responses) to execute the entire Agency Order at a price or prices better than the stop price, the Agency Order would be executed against such better priced interest with public customers having priority at each price level. After public customer interest at a particular price level has been satisfied, including all-or-none orders with a size which can be satisfied, remaining contracts would be allocated among all Exchange quotes, orders and Responses in accordance with Rules 1014(g)(vii)(B)(1)(b) and (d), and the Solicited Order would be cancelled.[50]

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[50] Similarly, pursuant to proposed Rule 1081(ii)(E)(3), in the case of a Complex Solicitation Auction, if there is sufficient size (considering resting Complex Orders and Responses) to execute the entire Complex Agency Order at a price(s) better than the stop price, the Complex Agency Order would be executed against better priced Complex Orders, Responses, as well as quotes and orders which comprise the cPBBO at the end of the

Example of Solicitation Auction with Sufficient Improving Interest. To illustrate a case where a Solicitation Auction yields enough improving interest to better the stop price and the application of the proposed Rule 1081(ii)(E)(1) algorithm, assume the NBBO is $0.95 – $1.03, and a buy side Agency Order for 1000 contracts is submitted with a contra-side Solicited Order to stop the Agency Order at $1.00. During the Solicitation Auction, assume a market maker ("MM1") Response is submitted to sell 800 contracts at $0.97, a broker-dealer Response is submitted to sell 100 contracts at $0.99, and a public customer sends in an order, outside of the Solicitation Auction, to sell 100 contracts at $0.99. Upon receipt of the public customer order, the NBBO changes to $0.95 - $0.99. In addition, assume two market makers send in quotes of $0.95 - $0.99 during the Solicitation Auction. Market Maker 2 ("MM2") quotes $0.95 - $0.99

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Complex Solicitation Auction. (The cPBBO is not considered in determining whether there is sufficient improving size because the market and/or size of the individual components can change between the calculation of sufficient size and the actual execution.) Such interest would be allocated at a given price in the following order: (i) to public customer Complex Orders and Responses in time priority; (ii) to SQT, RSQT, and non-SQT ROT Complex Orders and Responses on a size pro-rata basis; (iii) to non-market maker off-floor broker-dealer Complex Orders and Responses on a size pro-rata basis, and (iv) to quotes and orders which comprise the cPBBO at the end of the Complex Solicitation Auction with public customer interest being satisfied first in time priority, then to SQT, RSQT, and non-SQT ROT interest satisfied on a size pro-rata basis, and lastly to non-market maker off-floor broker-dealers on a size pro-rata basis. This allocation methodology is consistent with the allocation methodology utilized for a Complex Order executed in PIXL. In addition, providing public customer's with priority over SQT, RSQT, and non-SQT ROTs, who in turn have priority over non-market maker off-floor broker-dealers is the same priority scheme used for regular orders. See Rule 1014(g).

When determining if there is sufficient size to execute the entire Complex Agency Order at a price(s) better than the stop price, if the short sale price test in Rule 201 of Regulation SHO is triggered for a covered security, Complex Orders and Responses which are marked "short" will not be considered because of the possibility that a short sale price restriction may apply during the interval between assessing for adequate size and the execution of the Complex Agency Order. However, if there is sufficient size to execute the entire Complex Agency Order at a price(s) better than the stop price irrespective of any covered securities for which the price test is triggered that may be present, then all Complex Orders and Responses which are marked "short" will be considered for allocation in accordance with proposed Rule 1081(ii)(J)(3).

with 100 contracts and Market Maker 3 ("MM3") quotes $0.95 - $0.99 with 50 contracts. At the end of the Solicitation Auction, since there is enough interest to execute the entire Agency Order at a price(s) better than the stop price, the Agency Order would be executed against the better priced interest as follows:

- the Agency Order trades 800 contracts at $0.97 against MM1 Response;
- the Agency Order trades 100 contracts at $0.99 against public customer;
- the Agency Order trades 67 contracts at $0.99 against MM2 quote (pro-rata allocation); and
- the Agency Order trades 33 contracts at $0.99 against MM3 quote (pro-rata allocation).

The broker-dealer does not trade any contracts since broker-dealer orders execute only after all public customer and market maker interest is satisfied. The unexecuted Solicited Order and broker-dealer Response are cancelled back to the sending participants.[51]

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[51] To illustrate a Complex Solicitation Auction with enough improving interest and the operation of proposed Rule 1081(ii)(E)(3), assume that a Complex Order to buy one of option A and sell one of option B, 1000 times, with a cPBBO of $0.40 bid, $0.70 offer, is submitted with a stop price of $0.65. Assume that during the Solicitation Auction, the following Responses and order interest are received: a market maker ("MM1") responds to sell the strategy 100 times at a price of $0.55; MM1 responds to sell the strategy 100 times at a price of $0.60; a broker-dealer responds to sell the strategy 400 times at a price of $0.60; a public customer Complex Order to sell the strategy 300 times at a price of $0.60; and another market maker ("MM2") responds to sell the strategy 200 times at $0.60.

After all these Responses and orders are received, option A of the simple market moves causing the cPBBO to become offered 200 times at $0.60. Option A is quoted in the simple market as $1.00 – $1.10 and Option B is quoted in the simple market as $0.50 - $0.60. At the end of the Solicitation Auction, the Complex Agency Order would be executed as follows: the Complex Agency Order trades 100 contracts at $0.55 against MM1; the Complex Agency Order trades 300 contracts at $0.60 against public customer; the Complex Agency Order trades 100 contracts at $0.60 against MM1; the Complex Agency Order trades 200 contracts at $0.60 against MM2; the Complex Agency Order

Solicitation Auction with Insufficient Improving Interest. Pursuant to proposed Rule 1081(ii)(E)(2), if there is not sufficient size (considering all resting orders, quotes and Responses) to execute the entire Agency Order at a price(s) better than the stop price, the Agency Order would be executed against the Solicited Order at the stop price provided such price is better than the limit of any public customer order (excluding all-or-none) on the limit order book, on either the same side as or the opposite side of the Agency Order, and equal to or better than the contra-side PBBO.[52] Otherwise, both the Agency Order and Solicited Order would be cancelled without a trade occurring. This proposed behavior ensures non-contingent public customer orders on the limit order book maintain priority. While the Exchange recognizes that at least one other solicitation mechanism offered by another exchange considers public customer orders on the limit order book at the stop price when determining if there is sufficient improving interest to satisfy the Agency Order, the proposed solicitation mechanism offered on Phlx would not consider such interest.[53] The Exchange believes that requiring the stop price to

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trades 300 contracts at $0.60 against the broker-dealer; and the Solicited Order and the residual unexecuted contracts of the broker-dealer Response are cancelled.

52 Proposed Rule 1081(ii)(E)(2) does not apply to Complex Solicitation Auctions. Rather, a parallel provision, proposed Rule 1081(ii)(E)(4), provides that in a Complex Solicitation Auction, if there is not sufficient size (considering resting Complex Orders and Responses) to execute the entire Complex Agency Order at a price(s) better than the stop price, the Complex Agency Order would be executed against the Solicited Order at the stop price, provided such stop price is better than the limit of any public customer Complex Order (excluding all-or-none) on the Complex Order book, better than the cPBBO when a public customer order (excluding all-or-none) is resting on the book in any component of the Complex Agency Order, and equal to or better than the cPBBO on the opposite side of the Complex Agency Order. This proposed behavior ensures non-contingent public customers on the limit order book maintain priority. Otherwise, both the Complex Agency Order and the Solicited Order would be cancelled with no trade occurring.

53 See ISE Rule 716(e)(2)(i) which provides in part that in the case of insufficient improving interest "[i]f there are Priority Customer Orders on the Exchange on the opposite side of the Agency Order at the proposed execution price and there is sufficient

be at least $0.01 better than any public customer interest on the limit order book ensures public customer priority of existing interest and in turn provides the Solicited Order participant certainty that if an execution occurs at the stop price, such execution would represent the Solicited Order and not interest which arrived after the Solicited Order participant stopped the Agency Order for its entire size.

Example of Solicitation Auction with Insufficient Improving Interest. To illustrate a case where the Solicitation Auction has not yielded sufficient interest to improve the price for the entire Agency Order, assume the NBBO is $0.97 – $1.03, and a buy side Agency Order for 1000 contracts is submitted with a contra-side Solicited Order to stop the Agency Order at $1.00. During the Solicitation Auction, assume a Response is submitted to sell 100 contracts at $0.97 and another to sell 100 contracts at $0.99. At the end of the Solicitation Auction period, since there is not enough interest to execute the entire Agency Order at a price(s) better than the stop price, the Agency Order would be executed at $1.00 against the Solicited Order. The unexecuted Responses are then cancelled back to the sending participant. [54]

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size to execute the entire size of the Agency Order, the Agency Order will be executed against the bid or offer, and the solicited order will be cancelled."

[54] To illustrate a Complex Solicitation Auction that yields insufficient improving interest and the operation of proposed Rule 1081(ii)(E)(4), assume a Complex Order to buy one of option A and sell one of option B, 1000 times, with a cPBBO of $0.40 bid, $0.70 offer, is submitted with a stop price of $0.65. Assume that during the Complex Solicitation Auction, the following Responses and order interest are received: a market maker ("MM1") responds to sell the strategy 100 times at a price of $0.55; MM1 responds to sell the strategy 100 times at a price of $0.60; a broker-dealer responds to sell the strategy 300 times at a price of $0.60; and another market maker ("MM2") responds to sell the strategy 200 times at $0.60.

At the end of the Complex Solicitation Auction, since there is not sufficient size to execute the entire Complex Agency Order at a price(s) better than the stop price, the Complex Agency Order executes at the stop price of $0.65 against the Solicited Order. All unexecuted Responses are cancelled back to the sending participants.

Proposed Rule 1081(ii)(E)(6) provides that a single quote, order or Response shall not be allocated a number of contracts that is greater than its size.

Finally, proposed Rule 1081(ii)(E)(7) provides that a Complex Agency Order consisting of a stock/ETF component would not execute against interest comprising the cPBBO at the end of the Complex Solicitation Auction.[55] Legging of a stock/ETF component would introduce the risk of a participant not receiving an execution on all components of the Complex Order and is therefore not considered as a means of executing a Complex Order which includes a stock/ETF component. The Exchange believes that introducing the risk of inability to fully execute a complex strategy is counterproductive to, and inconsistent with, the effort to allow Complex Orders in the solicitation mechanism.

Miscellaneous Provisions

Proposed Rules 1081(ii)(F) through (I) address the handling of the Agency Order and other orders, quotes and Responses when certain conditions are present. Pursuant to proposed Rule 1081(ii)(F), if the market moves following the receipt of a Response, such that there are Responses that cross the then-existing NBBO (provided such NBBO is not crossed) at the time of the conclusion of the Solicitation Auction, such Responses would be executed, if possible, at their limit price(s).[56] Since Responses may be cancelled at any time prior to the conclusion of the Solicitation Auction, the Exchange believes that this behavior is, at best, highly unlikely as

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55 This provision parallels PIXL Rule 1080(n)(ii)(E)(2)(g) and is being proposed for the same reasons explained in the Complex PIXL Filing. This limitation is also consistent with the handling of Complex Orders that include a stock/ETF component and are entered into the Phlx XL system. Commentary .08(a)(i) to Rule 1080 states, for example, that stock-option orders can only be executed against other stock-option orders and cannot be executed by the System against orders for the individual components.

56 Similarly, in the case of a Complex Solicitation Auction, if there are Responses that cross the then-existing cPBBO at the time of conclusion of the Complex Solicitation Auction, such Responses would be executed, if possible, at their limit prices. This provision parallels PIXL Rule 1080(n)(ii)(F).

participants would cancel Responses when better priced interest that they could trade against is present in the marketplace. This behavior is consistent with the current handling of PAN Responses in a PIXL Auction.

Proposed Rule 1081(ii)(G) provides that if the Solicitation Auction price when trading against non-solicited interest (except if it is a Complex Solicitation Auction) would be the same as or cross the limit of an order (excluding an all-or-none order) on the limit order book on the same side of the market as the Agency Order, the Agency Order may only be executed at a price that is at least $0.01 better than the resting order's limit price provided such execution price improves the stop price. If such execution price would not improve the stop price, the Agency Order would be executed at a price which is $0.01 better for the Agency Order than the stop price provided the price does not equal or cross a public customer order and is equal to or improves upon the PBBO on the opposite side of the Agency Order.[57] If such price is not possible, the Agency Order and Solicited Order would be cancelled with no trade occurring. For example, assume the NBBO is $1.03 – $1.10 when an order is submitted into the Solicitation Auction, that the Agency Order is buying and that the order is stopped at $1.05. The $1.03 bid is

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[57] See also PIXL Rule 1080(n)(ii)(H). Proposed Rule 1081(ii)(G) does not apply to Complex Solicitation Auctions. Rather, a parallel provision, proposed Rule 1081(ii)(H), provides that if the Complex Solicitation Auction price when trading against non-solicited interest would be the same as or cross the limit of that of a Complex Order (excluding all-or-none) on the Complex Order Book on the same side of the market as the Complex Agency Order, the Complex Agency Order may only be executed at a price that improves the resting order's limit price by at least $0.01, provided such execution price improves the stop price. If such execution price would be equal to or would not improve the stop price, the Agency Order would be executed $0.01 better than the stop price provided the price does not equal or cross a non-all-or-none public customer Complex Order or a non-all-or-none public customer order present in the cPBBO on the same side as the Complex Agency Order in a component of the Complex Order Strategy and is equal to or better than the cPBBO on the opposite side of the Complex Agency Order. If such price is not possible, the Agency Order and Solicited Order would be cancelled with no trade occurring. This functionality is consistent with that of Complex PIXL auctions.

an order on Phlx. During the Solicitation Auction a Response arrives to sell at $1.03. At the end of the Solicitation Auction, if the Response to sell at $1.03 can fully satisfy the Agency Order, the auction price would be $1.03 but, since that price is the same as the price of a resting order on the book, the Agency Order would trade against the Response at $1.04 (an improvement of $0.01 over the resting order's limit). By contrast, assume a case where the NBBO is $1.03 - $1.10 and where during the Auction an unrelated non-customer order to pay $1.04 is received. This order rests on the book and the NBBO becomes $1.04 - $1.10. Assume the same stop price of $1.05 for an Agency Order to buy, and the receipt of a Response to sell at $1.04 which can fully satisfy the Agency order. At the end of the Solicitation Auction, the auction price would be $1.04 which equals the resting order on the book. In this case, if the trade were executed with $0.01 improvement over the resting order limit (that is, if the trade were executed at $1.05) the execution would be at the stop price. The system would not consider the origin of the resting order but ensures the priority of such order, regardless of origin by requiring that any execution occur at a price which improves upon the limit of a resting order by at least $0.01. In addition, the system only would permit the Solicited Order and no other interest to trade against the Agency Order at the stop price since the Solicited Order stopped the entire size Agency Order at a price which was required upon receipt to be equal to or improve the NBBO and to be at least $0.01 improvement over any public customer orders resting on the Phlx limit order book, thereby establishing priority at the stop price. Therefore, the execution price in this case ($1.04) would be $0.01 better than the stop price. This system logic ensures that the Agency Order receives a better priced execution than the stop price when trading against interest other than the Solicited Order.

Proposed Rule 1081(ii)(I) provides that any unexecuted Responses or Solicited Orders would be cancelled at the end of the Solicitation Auction. This behavior is consistent with the handling of unexecuted PAN Responses and Initiating Orders in PIXL.[58] Both Responses and Solicited Orders are specifically entered into the Solicitation Auction to trade against the Agency Order. The Exchange believes that cancelling the unexecuted portion of Responses and Solicited Orders is consistent with the expected behavior of such interest by the submitting participants.

Complex Agency Orders with Stock/ETF Components

Proposed Rule 1081(ii)(J) deals with Complex Agency Orders with stock or ETF components and generally tracks Rule 1080(n)(ii)(J) applicable to PIXL. Proposed Rule 1081(ii)(J)(1) states that member organizations may only submit Complex Agency Orders, Complex Solicited Orders, Complex Orders and/or Responses with a stock/ETF component if such orders/Responses comply with the Qualified Contingent Trade Exemption from Rule 611(a) of Regulation NMS pursuant to the Act. Member organizations submitting such orders with a stock/ETF component represent that such orders comply with the Qualified Contingent Trade Exemption. Members of FINRA or the NASDAQ Stock Market ("NASDAQ") are required to have a Uniform Service Bureau/Executing Broker Agreement ("AGU") with Nasdaq Execution Services LLC ("NES") in order to trade orders containing a stock/ETF component; firms that are not members of FINRA or NASDAQ are required to have a Qualified Special Representative ("QSR") arrangement with NES in order to trade orders containing a stock/ETF component.

Proposed Rule 1081(ii)(J)(2) provides that where one component of a Complex Agency Order, Complex Solicited Order, Complex Order or Response is the underlying security, the Exchange shall electronically communicate the underlying security component of the Complex

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[58] See Rule 1080(n)(ii)(I).

Agency Order (together with the Complex Solicited Order or Response, as applicable) to NES, its designated broker-dealer, for immediate execution.

Such execution and reporting would occur otherwise than on the Exchange and would be handled by NES pursuant to applicable rules regarding equity trading.

Finally, proposed Rule 1081(ii)(J)(3) states that when the short sale price test in Rule 201 of Regulation SHO[59] is triggered for a covered security, NES would not execute a short sale order in the underlying covered security component of a Complex Agency Order, Complex Solicited Order, Complex Order or Response if the price is equal to or below the current national best bid.[60] However, NES would execute a short sale order in the underlying covered security component of a Complex Agency Order, Complex Solicited Order, Complex Order or Response if such order is marked "short exempt," regardless of whether it is at a price that is equal to or below the current national best bid.[61] If NES could not execute the underlying covered security component of a Complex Agency Order, Complex Solicited Order, Complex Order or Response in accordance with Rule 201 of Regulation SHO, the Exchange would cancel back the Complex Agency Order, Complex Solicited Order, Complex Order or Response to the entering member

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59 17 CFR 242.201. See Securities Exchange Act Release No. 61595 (February 26, 2010), 75 FR 11232 (March 10, 2010). See also Division of Trading and Markets: Responses to Frequently Asked Questions Concerning Rule 201 of Regulation SHO, January 20, 2011 ("SHO FAQs") at www.sec.gov/divisions/marketreg/mrfaqregsho1204.htm.

60 The term "national best bid" is defined in SEC Rule 201(a)(4). 17 CFR 242.201(a)(4).

61 The Exchange notes that a broker or dealer may mark a sell order "short exempt" only if the provisions of SEC Rule 201(c) or (d) are met. 17 CFR 242.200(g)(2). Since NES and the Exchange do not display the stock or ETF portion of a Complex Order, however, a broker-dealer should not mark the short sale order "short exempt" under Rule 201(c). See SHO FAQs Question and Answer Nos. 4.2, 5.4, and 5.5. See also Securities Exchange Act Release No. 63967 (February 25, 2011), 76 FR 12206 (March 4, 2011) (SR-Phlx-2011-27) (discussing, among other things, Complex Orders marked "short exempt") and the Complex PIXL Filing. The system would handle short sales of the orders and Responses described herein the same way it handles the short sales discussed in the Complex PIXL Filing.

organization. For purposes of this paragraph, the term "covered security" has the same meaning as in Rule 201(a)(1) of Regulation SHO.[62]

Regulatory Issues

The proposed rule change contains two paragraphs describing prohibited practices when participants use the solicitation mechanism. These new provisions track similar provisions in the PIXL rule.[63]

Proposed Rule 1081(iii) states that the Solicitation Auction may be used only where there is a genuine intention to execute a bona fide transaction. It would be considered a violation of proposed Rule 1081 and would be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 707 if an Initiating Member submits an Agency Order (thereby initiating a Solicitation Auction) and also submits its own Response in the same Solicitation Auction. The purpose of this provision is to prevent Solicited Members from submitting an inaccurate or misleading stop price or trying to improve their allocation entitlement by participating with multiple expressions of interest.

Proposed Rule 1081(iv) states that a pattern or practice of submitting unrelated orders or quotes that cross the stop price causing a Solicitation Auction to conclude before the end of the Solicitation Auction period would be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 707.

Definition of Professional in Rule 1000(b)(14)

In addition to proposing Rule 1081, the Exchange also proposes an amendment to Rule 1000(b)(14). In 2010, the Exchange amended its priority rules to give certain non-broker-dealer orders the same priority as broker-dealer orders. In so doing, the Exchange adopted a new

62 17 CFR 242.201(a)(4).

63 See Rules 1080(n)(iii) and (iv).

defined term, the "professional," for certain persons or entities.[64] Rule 1000(b)(14) defines professional 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). A professional account is treated in the same manner as an off-floor broker-dealer for purposes of Phlx Rule 1014(g), to which the trade allocation algorithm described in proposed Rule 1081(ii)(E)(1) refers. However, Rule 1000(b)(14) also currently states that all-or-none professional orders would be treated like customer orders. The Exchange proposes to amend Rule 1000(b)(14) by (i) specifying that orders submitted pursuant to Rule 1081 for the accounts of professionals would be treated in the same manner as off-floor broker-dealer orders for purposes of Rule 1014(g), and (ii) adding proposed Rule 1081 to the list of rules for the purpose of which a professional would be treated in the same manner as an off-floor broker-dealer. The effect of these changes to Rule 1014 is that professionals would not receive the same priority afforded to public customers in a Solicitation Auction under proposed Rule 1081, and instead would be treated as broker-dealers in this regard.

III. Proceedings to Determine Whether to Approve or Disapprove SR-Phlx-2014-66 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act[65] to determine whether the proposed rule change should be approved or disapproved.[66] Institution

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64 See Securities Exchange Act Release No. 61802 (March 30, 2010), 75 FR 17193 (April 5, 2010) (approving SR-Phlx-2010-05).

65 15 U.S.C. 78s(b)(2)(B).

66 Section 19(b)(2)(B) of the Act provides that proceedings to determine whether to disapprove a proposed rule change must be concluded within 180 days of the date of publication of notice of the filing of the proposed rule change. The time for conclusion of the proceedings may be extended for up to an additional 60 days if the Commission finds good cause for such extension and publishes its reasons for so finding or if the self-regulatory organization consents to the extension.

of such proceedings is appropriate at this time in view of the legal and policy issues that are raised by the proposal and are discussed below. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as described in greater detail below, the Commission seeks and encourages interested persons to comment on the proposal and inform the Commission's analysis whether to approve or disapprove the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Act, the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of, and input from, commenters with regard to the proposed rule change's consistency with Section 6 of the Act, and in particular Sections 6(b)(5).[67] Section 6(b)(5) requires that the rules of an exchange be designed, among other things, to prevent fraudulent and manipulative acts and practices, 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; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.[68]

IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data and arguments with respect to the concerns identified above, as well as any others they may have with the proposal. In particular, the Commission invites the written views of interested persons concerning whether the proposed rule change is inconsistent with Section 6 or any other provision, of the Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral

67 15 U.S.C. 78f(b)(5).

68 15 U.S.C. 78f(b)(5).

presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.[69]

In addition to any other facets of the proposal on which persons may seek to comment, the Commission is soliciting the views of interested persons regarding provisions of the proposed rule change concerning the handling of all-or-none orders. The Commission notes that, in the case of a Solicitation Auction for simple orders, all interest on the opposite side of the Agency Order would be considered in determining whether the price has been improved for the full size of the Agency Order.[70] However, in the case of a Complex Order auction, all-or-none interest would not be considered.[71] As discussed above, the Exchange explains that this difference is due to a system limitation relating to all-or-none Complex Orders: "All-or-none simple orders reside with simple orders on the book. By contrast, all-or-none Complex Orders reside in a separate book, in a different part of the trading system. Thus aggregation of all-or-none Complex Orders with other Complex Orders in order to determine the presence of sufficient improving interest is a more difficult process than aggregation of all-or-none simple orders with other simple orders."

The Commission notes the impact that the proposed difference in treatment of all-or-none Complex Orders would have. For example, if a proposed cross was submitted to the Solicitation Auction for 1000 contracts at a certain price, and during the auction period an all-or-none order for the full 1000 contracts was received by the Exchange in its Complex Order book at a superior

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69 Section 19(b) (2) of the Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

70 See proposed Rule 1081(ii)(E)(1).

71 See proposed Rule 1081(ii)(E)(5).

price, the Agency Order nonetheless would be awarded to the solicited party at the stop price. As discussed above, Phlx argues that not counting all-or-none interest in the case of all-or-none Complex Orders would not be impactful, maintaining that all-or-none Complex Orders are rare.[72]

The Commission seeks comment on this feature of the Solicitation Mechanism. The Commission notes that a critical factor in its consideration of prior solicited order mechanism proposals has been whether the Agency Order was adequately exposed to all potential price improvement before the Solicited Order may trade against it at the proposed cross price.

In addition, the Commission seeks comment on the proposal's consideration of all-or-none orders that are resting on the book at the stop price at the conclusion of the auction (in both simple and Complex Order solicitations). The proposed rules provide, generally, that if, upon the conclusion of an auction, a public customer order is resting on the book opposite the Agency Order at the Solicited Order's stop price, both the Solicited Order and the Agency Order are canceled. However, if the public customer order was an all-or-none order, the proposal provides that the execution of the Solicited Order against the Agency Order can take place.[73] The Commission understands this result to apply even if the size of the all-or-none public customer order was such that it otherwise would be eligible to trade against the Agency Order. The Commission seeks commenters' views on this feature of the Solicitation Mechanism.[74]

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72 The Exchange states that it reviewed six months of data which showed that all-or-none Complex Orders represented only 0.12% of all Complex Orders. See supra note 49. The Exchange also notes that the proposed rule provides that, if sufficient size exists to execute the entire Complex Agency Order at an improved price, an all-or-none Complex Order would be considered for trade and executed if possible.

73 See proposed Rule 1081(ii)(E)(2).

74 See also supra, text accompanying footnote 30, regarding deference to all-or-none orders in the context of crossing two public customer orders.

The Commission further requests commenters' views on Phlx's proposed cancellation of the Agency Order (along with the Solicited Order) in certain cases where non-solicited interest is present that could fill the Agency Order. The Commission notes, for example, one result of proposed Rule 1081(ii)(G), which concerns a situation (in the case of simple orders) where the non-solicited interest has improved the price to a price that is the same as, or would cross, the limit of an order on the limit order book on the same side of the market as the Agency Order. The Commission understands the proposed rule as providing that the Agency Order would be permitted to be executed only at a price that is at least $0.01 better (i.e., toward the opposite side) than the resting order's limit price. However, if that price, as adjusted by $.01, would be equal to (i.e., would not improve) the stop price, the non-solicited interest would not be permitted to execute against the Agency Order at that price. In such case, as the Commission understands the proposal, the price would be adjusted back to $.01 better (for the Agency Order) than the stop price, but only if the resting limit order on the Agency Order side is not a public customer order. Otherwise, the Agency Order and Solicited Order would be cancelled with no trade occurring.

With respect to this cancellation scenario, as discussed above, Phlx explains that "the system only would permit the Solicited Order and no other interest to trade against the Agency Order at the stop price since the Solicited Order stopped the entire size Agency Order at a price which was required upon receipt to be equal to or improve the NBBO and to be at least $0.01 improvement over any public customer orders resting on the Phlx limit order book, thereby establishing priority at the stop price." The Commission seeks comment on this rationale and its result.

Another example concerns a case where, at the conclusion of the auction period, a public customer order is resting on the book on the opposite side of the Agency Order at the stop price.

As noted by the Exchange, its proposed rule and another exchange's solicited order mechanism rule[75] prohibit the execution of the Solicited Order in such a case. However, the proposed Phlx rule differs from the other exchange's rule in a case where, in addition to the public customer order at the stop price, there is price-improving interest of a size that is of insufficient size to fill the entire Agency Order on its own, but, when aggregated with the size of the public customer order, could fill the Agency Order. On the other exchange, while the Solicited Order is cancelled, the public customer order at the stop price and the improving interest trade against the Agency Order. Under the Phlx's proposal, the Agency Order and Solicited Order are cancelled.

The Exchange explains that its system "only permits the Solicited Order and no other interest to trade against the Agency Order at the stop price, thus ensuring that the Agency Order receives a better priced execution than the stop price when trading against interest other than the Solicited Order." The Commission notes that, when there is a public customer order on the book at the stop price, the Solicited Order would not be permitted to trade in any case, because a public customer on the book cannot be bypassed by another order. The Commission seeks comment on the aspect of the Exchange's proposal that would cancel the Agency Order and the Solicited Order in a case where there is public customer interest at the stop price, and together with any improving interest, the Agency Order otherwise could be satisfied.

The Commission further seeks commenters' views regarding the proposal's provisions regarding participation and priority in the allocation of the Agency Order, with respect to the Solicited Order and with respect to Responses, quotes and orders.

For example, under the proposal, one of the scenarios in which a Solicitation Auction would conclude early is if there is a trading halt on the Exchange in the option series that is the

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75 See ISE Rule 716(e), Solicited Order Mechanism.

subject of the auction.[76] In such case, the Exchange's proposal provides that the entire Agency Order would be executed solely against the Solicited Order at the stop price, and any unexecuted Responses would be cancelled.[77] The Commission notes that there can be instances in which an unrelated order on the side opposite the Agency Order has arrived on the Exchange and is resting on the book at a price that is superior to the stop price (from the point of view of the Agency Order) when the trading halt occurs. By crossing the Agency Order against the Solicited Order at the stop price in this situation, the Exchange would be executing a trade at a price that is inferior to a price on the Exchange's book. As noted above, the Exchange believes that public customer interest submitted to Phlx after submission of the Agency and Solicited Orders but prior to the trading halt should not prevent the Agency Order from being executed at the stop price since such public customer interest was not present at the time the Agency Order was 'stopped' by the Solicited Order.[78] The Commission solicits comment on this functionality and the Exchange's rationale.

Interested persons are invited to submit written data, views and arguments regarding whether the proposed rule change should be approved or disapproved by [insert date 21 days

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76 See proposed Rule 1081(ii)(B)(4). The described scenario applies in a simple Solicitation Auction. In a Complex Solicitation Auction, the auction would end early any time there is a trading halt on the Exchange in any component of the Complex Agency Order. Id.

77 See proposed Rule 1081(ii)(C).

78 In explaining generally why Responses and other interest present in the system would not be considered for trading against the Agency Order in the case of a trading halt – which, the Commission notes, would apply even when the aggregate of such Responses and other interest was sufficient to fill the entire Agency Order at an improved price – the Exchange stated that "this is appropriate since the participants representing tradable interest in the Solicitation Auction have not 'stopped' the Agency Order in its entirety and would have no means after the auction executions occur to offset the trading risk they would incur because the market is halted if they were permitted to trade against the Agency Order in this instance."

from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register].

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-2014-66 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-2014-66. 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 such 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 publicly available. All submissions should refer to File Number SR-Phlx-2014-66 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. If comments are received, any rebuttal comments should be submitted by [insert date 35 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[79]

Jill M. Peterson
Assistant Secretary

[79] 17 CFR 200.30-3(a)(57).