

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-60459; File No. SR-Phlx-2009-54)

August 7, 2009

Self-Regulatory Organizations; NASDAQ OMX PHLX, Inc.; Order Approving a Proposed Rule Change to Establish Fees for the Top of Phlx Options Direct Data Feed Product

I. Introduction

On June 30, 2009, NASDAQ OMX PHLX, Inc. (“Phlx” or “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 amend its fee schedule by establishing subscriber fees for a direct data product related to the trading of standardized options on the Exchange’s enhanced electronic trading platform for options, Phlx XL II.³ Notice of the proposed rule change was published for comment in the Federal Register on July 8, 2009.⁴ The Commission received no comments on the proposal. This order approves the proposed rule change.

II. Description of the Proposal

In conjunction with the launch and rollout of its Phlx XL II system, the Exchange is developing Top of Phlx Options (“TOPO”), a direct data feed product that includes the Exchange’s best bid and offer price, with aggregate size, based on displayable order and quoting interest on the Phlx XL II system. The data contained in the TOPO data feed is

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 59995 (May 28, 2009), 74 FR 26750 (June 3, 2009) (SR-Phlx-2009-32).

⁴ See Securities Exchange Act Release No. 60202 (June 30, 2009), 74 FR 32675 (“Notice”).

identical to the data sent to the processor for the Options Price Regulatory Authority (“OPRA”), and the TOPO and OPRA data will leave the Phlx XL II System at the same time.

In coordination with the projected completion of the rollout of the Phlx XL II system, the Exchange proposes to charge monthly fees to distributors, beginning August 1, 2009, for use of TOPO.⁵ The monthly “Distributor Fee” charged will depend on whether the distributor is an “Internal Distributor” or an “External Distributor.”⁶ Specifically, the Exchange proposed to charge Internal Distributors a monthly fee of \$2,000 per organization and to charge External Distributors a monthly fee of \$2,500 per organization.

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁷ In particular, the Commission finds that the

⁵ A “distributor receives a feed or data file of data directly from NASDAQ OMX PHLX or indirectly through another entity and then distributes it either internally or externally. All distributors will be required to execute a NASDAQ OMX PHLX distributor agreement.

⁶ An Internal Distributor is an organization that subscribes to the Exchange for the use of TOPO, and is permitted by agreement with the Exchange to provide TOPO data to internal users (i.e., users within their own organization). An External Distributor is an organization that subscribes to the Exchange for the use of TOPO, and is permitted by agreement with the Exchange to provide TOPO data to both internal users and to external users (i.e., users outside of their own organization).

⁷ In approving this proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

proposed rule change is consistent with the requirements of Section 6(b)(4) of the Act,⁸ which requires that the rules of a national securities exchange provide for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using its facilities, and Section 6(b)(5) of the Act,⁹ which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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 not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers. The Commission also finds that the proposed rule change is consistent with Section 6(b)(8) of the Act¹⁰ in that it does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

The Commission has reviewed the proposal using the approach set forth in the approval order for SR-NYSEArca-2006-21 for non-core market data fees.¹¹ In the NYSE Arca Order, the Commission stated that “when possible, reliance on competitive forces is the most appropriate and effective means to assess whether the terms for the distribution of non-core data are equitable, fair and reasonable, and not unreasonably

⁸ 15 U.S.C. 78f(b)(4).

⁹ 15 U.S.C. 78f(b)(5).

¹⁰ 15 U.S.C. 78f(b)(8).

¹¹ See Securities Exchange Act Release No. 59039 (December 2, 2008), 73 FR 74770 (December 9, 2008) (SR-NYSEArca-2006-21) (“NYSE Arca Order”).

discriminatory.”¹² It noted that the “existence of significant competition provides a substantial basis for finding that the terms of an exchange’s fee proposal are equitable, fair, reasonable, and not unreasonably or unfairly discriminatory.”¹³ If an exchange “was subject to significant competitive forces in setting the terms of a proposal,” the Commission will approve a proposal unless it determines that “there is a substantial countervailing basis to find that the terms nevertheless fail to meet an applicable requirement of the Exchange Act or the rules thereunder.”¹⁴

As noted in the NYSE Arca Order, the standards in Section 6 of the Act do not differentiate between types of data and therefore apply to exchange proposals to distribute both core data and non-core data.¹⁵ All U.S. options exchanges are required pursuant to the Plan for Reporting of Consolidated Options Last Sale Reports and Quotation Information (“OPRA Plan”) to provide “core data” -- the best-priced quotations and comprehensive last sale reports -- to OPRA, which data is then distributed to the public pursuant to the OPRA Plan.¹⁶ In contrast, individual exchanges and other market participants distribute non-core data voluntarily.¹⁷ The mandatory nature of the core data disclosure regime leaves little room for competitive forces to determine products and fees.¹⁸ Non-core data products and their fees are, by contrast, much more sensitive to competitive forces. The Commission therefore is able to rely on competitive

¹² Id. at 74771.

¹³ Id. at 74782.

¹⁴ Id. at 74781.

¹⁵ Id. at 74779.

¹⁶ See OPRA Plan, Sections V(a)-(c).

¹⁷ See NYSE Arca Order, supra, note 11, at 74779.

¹⁸ Id.

forces in its determination of whether an exchange's proposal to distribute non-core data meets the standards of Section 6.¹⁹

Because Phlx's instant proposal relates to the distribution of non-core data, the Commission will apply the market-based approach set forth in the NYSE Arca Order. Pursuant to this approach, the first step is to determine whether Phlx was subject to significant competitive forces in setting the terms of its non-core market data proposal, including the level of any fees. As in the NYSE Arca Order, in determining whether Phlx was subject to significant competitive forces in setting the terms of its proposal, the Commission has analyzed Phlx's compelling need to attract order flow from market participants, and the availability to market participants of alternatives to purchasing Phlx's non-core market data.

The Commission believes that the options industry currently is subject to significant competitive forces. It is generally accepted that the start of wide-spread multiple listing of options across exchanges in August 1999 greatly enhanced competition among the exchanges.²⁰ The launch of three options exchanges since that

¹⁹ Id.

²⁰ See generally Concept Release: Competitive Developments in the Options Markets, Securities Exchange Act Release No. 49175 (February 3, 2004), 69 FR 6124 (February 9, 2004); see also Battalio, Robert, Hatch, Brian, and Jennings, Robert, Toward a National Market System for U.S. Exchange-listed Equity Options, *The Journal of Finance* 59 (933-961); De Fontnouvelle, Patrick, Fische, Raymond P., and Harris, Jeffrey H., The Behavior of Bid-Ask Spreads and Volume in Options Markets During the Competition for Listings in 1999, *The Journal of Finance* 58 (2437-2463); and Mayhew, Stewart, Competition, Market Structure, and Bid-Ask Spreads in Stock Option Markets, *The Journal of Finance* 57 (931-958).

time, numerous market structure innovations, and the start of the options penny pilot²¹ have all further intensified intermarket competition for order flow.²²

Phlx currently competes with six options exchanges for order flow.²³ Attracting order flow is an essential part of Phlx's competitive success.²⁴ If Phlx cannot attract order flow to its market, it will not be able to execute transactions. If Phlx cannot execute transactions on its market, it will not generate transaction revenue. If Phlx cannot attract orders or execute transactions on its market, it will not have market data to distribute, for a fee or otherwise, and will not earn market data revenue and thus not be competitive with other exchanges that have this ability. In its filing, Phlx provided market share data for the seven options exchanges.²⁵

These market share percentages strongly indicate that Phlx must compete vigorously for order flow to maintain its share of trading volume. This compelling need

²¹ See, e.g., Securities Exchange Act Release Nos. 55162 (January 24, 2007), 72 FR 4738 (February 1, 2007) (SR-Amex-2006-106); 55073 (January 9, 2007), 72 FR 4741 (February 1, 2007) (SR-BSE-2006-48); 55154 (January 23, 2007), 72 FR 4743 (February 1, 2007) (SR-CBOE-2006-92); 55161 (January 24, 2007), 72 FR 4754 (February 1, 2007) (SR-Phlx-2006-62); 55156 (January 23, 2007), 72 FR 4759 (February 1, 2007) (SR-NYSEArca-2006-73); and 55153 (January 23, 2007), 72 FR 4553 (January 31, 2007) (SR-Phlx-2006-74).

²² See Securities Exchange Act Release No. 59949 (May 20, 2009), 74 FR 25593 (May 28, 2009) (SR-ISE-2007-97) (order approving a proposed rule change by ISE to establish fees for a depth of market data product).

²³ In its filing, Phlx states that “[a]n illustration of the intensity of the competition for options order flow among the seven U.S. options exchanges, the ISE and ... CBOE each enjoy close to thirty percent market share of volume, followed by Phlx at close to twenty percent market share, followed by four other exchanges with meaningful market share.” See Notice, supra, note 4, at 32676.

²⁴ Phlx states in its filing that it “has a compelling need to attract order flow from market participants ... in order to maintain its share of trading volume.” See Notice, supra, note 4, at 32676.

²⁵ See Notice, supra, note 4, at 32676.

to attract order flow imposes significant pressure on Phlx to act reasonably in setting its fees for Phlx market data, particularly given that the market participants that will pay such fees often will be the same market participants from whom Phlx must attract order flow. These market participants include broker-dealers that control the handling of a large volume of customer and proprietary order flow. Given the portability of order flow from one exchange to another, any exchange that sought to charge unreasonably high data fees would risk alienating many of the same customers on whose orders it depends for competitive survival.²⁶

Phlx currently trades options on seven proprietary index products that are not traded on any other exchange. Phlx represents that these seven options currently represent less than 0.04% of Phlx's total contract volume.²⁷ The Commission believes that, given the small percentage of Phlx's total contract volume represented by these seven products, the inclusion of data on these products in Phlx's TOPO product will not confer market power on Phlx to compel market participants to purchase the entire Phlx data feed. The Commission therefore believes that the inclusion of top-of-book data for these products in Phlx's TOPO product does not undermine the finding that Phlx was subject to significant competitive forces in setting the terms of its proposal.

In addition to the need to attract order flow, the availability of alternatives to TOPO product significantly affect the terms on which Phlx can distribute this market data.²⁸ In setting the fees for its TOPO product, Phlx must consider the extent to which market participants would choose one or more alternatives instead of purchasing its

²⁶ Id.

²⁷ Id.

²⁸ See NYSE Arca Order, supra note 11, at 74784.

data.²⁹ The most basic source of information concerning the top-of-book generally available at an exchange is the complete record of an exchange's transactions that is provided in the core data feeds.³⁰ In this respect, the core data feeds that include an exchange's own transaction information are a significant alternative to the exchange's market data product.³¹ Further, other options exchanges can produce their own top-of-book products, and thus are sources of potential competition for Phlx.³²

The Commission believes that there are a number of alternative sources of information that impose significant competitive pressures on Phlx in setting the terms for distributing its TOPO product. The Commission believes that the availability of those alternatives, as well as Phlx's compelling need to attract order flow, imposed significant competitive pressure on Phlx to act equitably, fairly, and reasonably in setting the terms of its proposal.

Because Phlx was subject to significant competitive forces in setting the terms of the proposal, the Commission will approve the proposal in the absence of a substantial countervailing basis to find that the terms of the proposal fail to meet the applicable requirements of the Act or the rules thereunder. The Commission did not receive any

²⁹ Id. at 74783.

³⁰ Id.

³¹ Id. Information on transactions executed on Phlx is available through OPRA.

³² In its filing, Phlx states that “ISE and CBOE are potential competitors because each exchange enjoys greater market share and thus the ability to offer a top-of-book product that would compete favorably with TOPO.” See Notice, supra, note 4, at 32677.

Phlx also notes that although the TOPO data feed is separate from the core data feed made available by OPRA, all of the information made available in TOPO is included in the core data feed. Phlx states that the OPRA data is widely distributed and relatively inexpensive, thus constraining Phlx’s ability to price TOPO. See Notice, supra, note 4, at 32677.

comments on the proposal. Further, an analysis of the proposal does not provide such a basis. The Commission notes that the proposed fees for TOPO are lower for Internal Distributors than for External Distributors. Because Internal Distributors are by definition more limited in the scope of their distribution of TOPO data than External Distributors, it is reasonable to expect that Internal Distributors will provide TOPO data to a smaller number of internal subscribers.³³ The fees therefore do not unreasonably discriminate among types of subscribers, such as by favoring participants in the Phlx market or penalizing participants in other markets.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-Phlx-2009-54), be and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁴

Florence E. Harmon
Deputy Secretary

³³ Conversely, External Distributors can reasonably be expected to distribute the TOPO data to a higher number of subscribers because they do not have the same limitation. Accordingly, the Exchange will charge a higher fee to External Distributors than to Internal Distributors. See id.

³⁴ 17 CFR 200.30-3(a)(12).