

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-84727; File No. SR-Phlx-2018-77)

December 6, 2018

Self-Regulatory Organizations; Nasdaq PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Bid/Ask Differentials

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on November 28, 2018, Nasdaq PHLX LLC (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend Phlx Rule 1017, entitled “Openings in Options,” Phlx Rule 1014, entitled “Obligations and Restrictions Applicable to Specialists and Registered Options Traders,” and Rule 1000, entitled “Applicability, Definitions and References.”

The text of the proposed rule change is available on the Exchange’s Website at <http://nasdaqphlx.cchwallstreet.com/>, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Phlx proposes several amendments in this rule change. First, the Exchange proposes to amend Phlx Rule 1017, entitled “Openings in Options” and Phlx Rule 1014, entitled “Obligations and Restrictions Applicable to Specialists and Registered Options Traders” to correct inconsistencies between the Exchange’s rule text and the operation of the System. Second, the Exchange proposes to add definitions to Phlx Rule 1000 to define “in-the-money” and “out-of-the-money” option series. Third, the Exchange proposes to amend Rule 1014 to correct an error regarding rounding. Each amendment will be described in more detail below.

Rule 1017

Today, Phlx Rule 1017(a)(ix) defines a Valid Width Quotes as a two-sided electronic quotation submitted by a Phlx Electronic Market Maker (which includes a Specialist<sup>3</sup> and a Registered Options Trader<sup>4</sup> or “ROT”) or “ROT”) that consists of a bid/ask differential that is

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<sup>3</sup> A Specialist is an Exchange member who is registered as an options Specialist. See Phlx Rule 1020(a).

<sup>4</sup> Rule 1014(b) defines a ROT as “a regular member or a foreign currency options participant of the Exchange located on the trading floor who has received permission from the Exchange to trade in options for his own account.” For purposes of Rule 1014, the term “ROT” shall include a Streaming Quote Trader and a Remote Streaming Quote Trader, as defined in Rule 1014.

compliant with Rule 1014(c)(i)(A)(1)(a).<sup>5</sup> Specifically, for the Opening Process, Phlx Rule 1014(c)(i)(A)(1)(a) states that, for in-the-money series, the bid/ask differentials may be as wide as the spread between the national best bid and offer in the underlying security, or its decimal equivalent rounded up to the nearest minimum increment. In practice, however, the Exchange's System permits a Valid Width Quote in the Opening Process to be as wide as the quotation for the underlying security on the **primary** (listing) market.<sup>6</sup>

### Proposal

The Exchange proposes to codify its current practice and correctly reflect in its Rules that the Valid Width Quote in the Opening Process apply a primary market analysis, not a national best bid or offer ("NBBO") analysis.<sup>7</sup> Specifically, this proposal would conform the current rule text to the current System by amending the definition of a Valid Width Quote in Rule 1017, "Opening in Options," so that, in the case of in-the-money option series<sup>8</sup> where the market for the underlying security is wider than the differentials set forth above, the bid/ask differential set

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<sup>5</sup> Phlx Rule 1014(c)(i)(A)(1)(a) provides, "[o]ptions on equities and index options bidding and/or offering so as to create differences of no more than \$.25 between the bid and the offer for each option contract for which the prevailing bid is less than \$2; no more than \$.40 where the prevailing bid is \$2 or more but less than \$5; no more than \$.50 where the prevailing bid is \$5 or more but less than \$10; no more than \$.80 where the prevailing bid is \$10 or more but less than \$20; and no more than \$1 where the prevailing bid is \$20 or more, provided that, in the case of equity options, the bid/ask differentials stated above shall not apply to in-the-money series where the market for the underlying security is wider than the differentials set forth above. For such series, the bid/ask differentials may be as wide as the spread between the national best bid and offer in the underlying security, or its decimal equivalent rounded up to the nearest minimum increment. The Exchange may establish differences other than the above for one or more series or classes of options."

<sup>6</sup> The primary market has always been utilized on Phlx since the migration to Phlx XLII.

<sup>7</sup> The Exchange notes that today Phlx utilizes the primary market in calculating the bid/ask differential during the Opening Process. This rule change would amend the rule to reflect Phlx's current practice.

<sup>8</sup> An at-the-money option series would also qualify. An out-of-the-money series would not qualify.

forth in Phlx Rule 1017(a)(ix) may be as wide as the quotation for the underlying security on the primary<sup>9</sup> (listing) market, or its decimal equivalent rounded down to the nearest minimum increment.

The Exchange believes that utilizing the primary market in the Opening Process is reasonable given the close connection between the primary market and the Opening Process. For example, Phlx Rule 1017(d)(ii) provides, “For all options, the underlying security, including indexes, must be open on the primary market for a certain time period as determined by the Exchange for the Opening Process to commence. The time period shall be no less than 100 milliseconds and no more than 5 seconds.”

Today, in order to open, the Exchange requires either: (i) the Specialist’s Valid Width Quote; (ii) the Valid Width Quotes of at least two Phlx Electronic Market Makers other than the Specialist; or (iii) if neither the Specialist’s Valid Width Quote nor the Valid Width Quotes of two Phlx Electronic Market Makers have been submitted within such timeframe, one Phlx Electronic Market Maker has submitted a Valid Width Quote. The Exchange notes that it requires Specialists to submit Valid Width Quotes during the Opening Process to guarantee liquidity, unlike other markets which may not require market makers to quote during the opening.<sup>10</sup> Further, amending the rule text to conform to its current practice will avoid confusion and continue to permit Phlx to remain one of the strongest openings in the industry.

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<sup>9</sup> The term “primary market” means, in the case of securities listed on The Nasdaq Stock Market, the market that is identified as the listing market pursuant to Section X(d) of the approved national market system plan governing the trading of Nasdaq-listed securities, and, in the case of securities listed on another national securities exchange, the market that is identified as the listing market pursuant to Section XI of the Consolidated Tape Association Plan. See Phlx Rule 1000(b)(31).

<sup>10</sup> The Nasdaq Options Market (“NOM”) permits a bid/ask differential for options on equities and on index options to be quoted with a difference not to exceed \$5 between the

## Rule 1000

Phlx rules currently do not define an “in-the-money” or “out-of-the-money” option series. As part of this rule change, the Exchange proposes to define these above-referenced terms within Phlx Rule 1000(b) to bring greater transparency to its rules with respect to Phlx Electronic Market Maker quoting. The Exchange proposes to define the term “in-the-money” at Rule 1000(b)(51) as the following: for call options, all strike prices at or below the offer in the underlying security on the primary listing market; for put options, all strike prices at or above the bid in the underlying security on the primary listing market. The Exchange proposes to define the term “out-of-the-money” option at Rule 1000(b)(52), which is currently reserved, to mean the following: for call options, all strike prices above the offer in the underlying security on the primary listing market; for put options, all strike prices below the bid in the underlying security on the primary listing market.<sup>11</sup> Each of these definitions would apply for purposes of Phlx Electronic Market Maker quoting obligations in Rules 1014 and 1017. The Exchange notes that it specifically proposes to reference the rules related to Phlx Electronic Market Maker quoting obligations to avoid any confusion with the manner in which “in-the-money” and “out-of-the-money” options series are defined for purposes of other options rules.

## Rule 1014

The Exchange proposes to codify current rounding practice by amending Rule 1014(c)(i)(A)(1)(a). Today, Rule 1014(c)(i)(A)(1)(a) provides that rounding is up when

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bid and offer regardless of the price of the bid, including before and during the opening. See NOM Rules at Chapter VII, Section 6(d)(ii).

<sup>11</sup> The Exchange notes that it does not utilize a last sale calculation. The Exchange believes that the quotation for the underlying security on the primary market provides an accurate reflection of the market. A last sale calculation may not be an accurate reflection of the market because the last sale may not be representative of the primary market in all cases, particularly if a halt were to occur.

referring to decimal equivalent. Today, the decimal equivalent is rounded down not up. The Exchange proposes to conform its rule text to the current practice. The Exchange believes that the manner in which the Exchange rounds is immaterial, however the Exchange believes that it is important to disclose its method of rounding and uniformly apply such rounding. The Exchange proposes this amendment to make clear the manner in which it rounds the decimal equivalent. Today the Exchange uniformly applies this rounding to all market maker participants and will continue to apply it in a uniform manner.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>12</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>13</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest. The Exchange notes that today Phlx utilizes the primary market in calculating the bid/ask differential during the Opening Process, although the current rule does not reflect this practice. This rule change would amend the rule to reflect Phlx's current practice.

### Rule 1017

The Exchange's proposal to amend the Opening Process to conform to current practice is consistent with the Act because while the Exchange believes that relying on the primary market or the NBBO accurately reflect the current trading environment and take into consideration

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<sup>12</sup> 15 U.S.C. 78f(b).

<sup>13</sup> 15 U.S.C. 78f(b)(5).

market conditions, the Exchange's current Opening Process is designed to utilize the primary standard during the Opening Process.<sup>14</sup>

#### Rule 1000

The Exchange's proposal to define the terms "in-the-money" and "out-of-the-money" for purposes of Phlx Electronic Market Maker quoting obligations in Rules 1014 and 1017 is consistent with the Act and protects investors and the public interest by bringing greater transparency to the Rulebook. Each of these defined terms would apply for purposes of Phlx Electronic Market Maker quoting obligations in Rules 1014 and 1017. The Exchange notes that it specifically proposes to reference the rules related to Phlx Electronic Market Maker quoting obligations to avoid any confusion with the manner in which "in-the-money" and "out-of-the-money" options series are defined for purposes of other options rules.

#### Rule 1014

The Exchange's proposal to amend Rule 1014(c)(i)(A)(1)(a) to codify the Exchange's current practice of rounding down when referring to decimal equivalent is consistent with the protection of investor and the public interest because the Exchange is adding transparency to its current rule by disclosing its method of rounding.

#### B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

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<sup>14</sup> Phlx Rule 1017(d)(ii) provides, "For all options, the underlying security, including indexes, must be open on the primary market for a certain time period as determined by the Exchange for the Opening Process to commence. The time period shall be no less than 100 milliseconds and no more than 5 seconds."

### Rule 1017

The Exchange's proposal to codify its current practice of utilizing the primary market in the Opening Process does not unduly burden competition because the current practice maintains a close connection between the primary market and the Opening Process. The primary market reflects the current trading environment. The Exchange notes that the proposal does not create an undue burden on intra-market competition because Phlx Electronic Market Makers are the only market participants subject to quoting requirements and these participants have valuable information with respect to the underlying instrument under the current process to make informed decisions and take calculated risks in the marketplace when providing liquidity. Phlx Electronic Market Makers remain responsible for maintaining fair and orderly markets.

### Rule 1000

The Exchange's proposal to define the terms "in-the-money" or "out-of-the-money" for purposes of Phlx Electronic Market Maker quoting obligations in Rules 1014 and 1017 does not unduly burden competition, rather it adds greater transparency to the Rulebook and makes clear the applicability of the definitions to avoid confusion with respect to the remainder of the options rules.

### Rule 1014

The Exchange's proposal to codify its current practice of rounding down when referring to decimal equivalent within Rule 1014(c)(i)(A)(1)(a) does not impose an undue burden competition because the Exchange continues to uniformly apply its rounding methodology with respect to its market making participants.

### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were either solicited or received.



### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>15</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>16</sup>

A proposed rule change filed under Rule 19b-4(f)(6)<sup>17</sup> normally does not become operative prior to 30 days after the date of the filing. However, Rule 19b-4(f)(6)(iii)<sup>18</sup> permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has asked the Commission to waive the 30-day operative delay so that the proposal may become operative immediately upon filing. The Exchange states that immediately codifying its current practice within its rules to accurately reflect the operation of the Exchange's System will avoid confusion. The Commission believes that waiver of the 30-day operative delay is consistent with the protection of investors and the public interest. Accordingly, the Commission hereby waives the operative delay and designates the proposed rule change as operative upon filing.<sup>19</sup>

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<sup>15</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>16</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6)(iii) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change, along with a brief description and the text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

<sup>17</sup> 17 CFR 240.19b-4(f)(6).

<sup>18</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>19</sup> For purposes only of waiving the 30-day operative delay, the Commission has also considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is: (i) necessary or appropriate in the public interest; (ii) for the protection of investors; or (iii) otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act.

Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>);
- or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-Phlx-2018-77 on the subject line.

##### Paper Comments:

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

All submissions should refer to File Number SR-Phlx-2018-77. 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 the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-Phlx-2018-77 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>20</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>20</sup> 17 CFR 200.30-3(a)(12).