

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-67169; File No. SR-Phlx-2012-40)

June 8, 2012

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Order Approving Proposed Rule Change, as Modified by Amendment No. 1, Relating to Quarterly Trading Requirements Applicable to Registered Options Traders

I. Introduction

On March 26, 2012, NASDAQ OMX PHLX LLC (“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 change trading requirements applicable to certain Registered Options Traders trading electronically. The proposed rule change was published for comment in the Federal Register on April 13, 2012.³ The Commission received no comments on the proposal. On June 6, the Exchange filed Amendment No. 1 to the proposal.⁴ This order approves the proposal, as modified by Amendment No. 1.

II. Description

The Exchange proposed to amend the trading requirements imposed on certain Exchange market makers⁵ arising from their use of electronic orders to trade on the Exchange.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 66767 (April 6, 2012), 77 FR 22365. The Exchange subsequently extended the date for Commission action to June 4, 2012, and then to June 8, 2012.

⁴ The amendment is technical in nature, and is thus not subject to notice and comment.

⁵ The general term “market makers” on the Exchange includes specialists and registered options traders (“ROTs”). An ROT is a regular member of the Exchange located on the trading floor who has received permission from the Exchange to trade in options for his own account. See Exchange Rule 1014 (b)(i) and (ii). ROTs can be Streaming Quote Traders (“SQTs”), Remote Streaming Quote Traders (“RSQTs”), or non-Streaming

First, the Exchange proposed to amend Exchange Rule 1014, Commentary .13, which provides that within each quarter an ROT must execute in person, and not through the use of orders, a specified number of contracts, with such number to be determined from time to time by the Exchange. Pursuant to Commentary .13, Options Floor Procedure Advice B-3 requires that an ROT (other than an RSQT or a Remote Specialist) trade in person, and not through the use of orders, the greater of 1000 contracts or 50% of its contract volume on the Exchange each quarter. The Exchange proposed to amend both Commentary .13 and Options Floor Procedure Advice B-3 to permit non-SQT ROTs to meet the in-person trading requirements set forth in those sections using orders entered in person, for the same reasons that the Exchange recently modified the 80% in-person test set forth in Commentary .01 to Rule 1014.⁶

The Exchange also proposed to amend Exchange Rule 1014(b)(ii)(E) to eliminate the requirement that non-SQT ROTs who transact more than 20% of their contract volume in an

Quote Trader ROTs (“non-SQT ROTs”) which by definition are neither SQTs nor RSQTs. An ROT is a regular member of the Exchange located on the trading floor who has received permission from the Exchange to trade in options for his own account. See Exchange Rule 1014 (b)(i) and (ii). An SQT is defined as an ROT who has received permission from the Exchange to generate and submit option quotations electronically in options to which such SQT is assigned. See Exchange Rule 1014 (b)(ii)(A).

⁶ Prior to being amended, Commentary .01 required that in order for an ROT (other than an RSQT or a Remote Specialist) to receive specialist margin treatment for off-floor orders in any calendar quarter, the ROT was required, among other things, to execute the greater of 1,000 contracts or 80% of his total contracts that quarter in person and not through the use of orders (the “80% in-person test”). The only way to participate in trades other than through the use of orders is by quoting. In amending this provision, the Exchange explained that the limitation on the use of orders to satisfy the 80% in-person test with respect to non-SQT ROTs was obsolete as, given the movement toward more electronic trading in options, it had become difficult for such ROTs to comply with the trading requirement without using orders. The Exchange observed that non-SQT ROTs could only meet the 80% in person test by participating in crowd trades which they cannot control in terms of frequency, and proposed that the 80% in-person test be amended to permit non-SQT ROTs to count orders entered in person to meet the requirement. See Securities Exchange Act Release No. 65644 (October 27, 2011), 76 FR 67786 (November 2, 2011) (SR-Phlx-2011-123).

option electronically during any calendar quarter submit two-sided electronic quotations (also known as “streaming quotes”) in a designated percentage of series within options in which such non-SQT ROT is assigned (the “20% test”). The Exchange stated that streaming quotes is burdensome to non-SQT ROTs, who are generally not equipped to undertake this form of trading, and could result in a significant increase in fixed costs to these non-SQT ROTs. The Exchange stated that continuing to require non-SQT ROTs that execute more than 20% of their contract volume electronically to stream quotes would likely result in those ROTs leaving the trading floor in that option. The Exchange stated that price improvement, quality of execution, and especially price discovery would suffer if these non-SQT ROTs were forced out of open outcry market making. The Exchange therefore proposed to eliminate the 20% test and its associated requirements as a vestige of the early days of electronic trading.⁷ Instead, all non-SQT ROTs, regardless of their volume of electronic transactions, would be subject to the continuous open outcry quoting obligation that is currently only applicable to those non-SQT ROTs that trade less than 20% of their contract volume electronically. The Exchange represented that this proposal would affect a relatively small number of non-SQT ROTs. The Exchange also represented that this change would not detract from the current electronic trading environment.

The Exchange also proposed conforming changes to Exchange Rule 1014(b)(ii)(E)(1) to conform that provision to the recent amendment by the Exchange of Rule 1014, Commentary .01. Specifically, the Exchange proposed to delete Exchange Rule 1014(b)(ii)(E)(1)(c), which

⁷ In addition to deleting Exchange Rule 1014(b)(ii)(E)(2), the Exchange proposed to delete introductory language from the beginning of Exchange Rule 1014(b)(ii)(E) that would no longer be necessary. The substantive provisions of Exchange Rule 1014(b)(ii)(E)(1) governing non-SQT ROT obligations, as proposed to be renumbered and amended, would continue to apply.

provides that any volume transacted electronically will not count towards a non-SQT ROT's 80% in-person test contained in Commentary .01 to Rule 1014. As described above, recently amended Commentary .01 eliminated this restriction and the Exchange stated that Exchange Rule 1014(b)(ii)(E)(1)(c) was no longer necessary.

Finally, the Exchange proposed to eliminate a reference from Rule 1093(a), the Phlx XL Risk Monitor Mechanism, which refers to non-SQT ROTs that are required to stream two-sided quotes electronically pursuant to Rule 1014(b)(ii)(E). As described above, the Exchange proposes to remove the requirement from Rule 1014(b)(ii)(E) that non-SQT ROTs stream quotes electronically, and is making this conforming change to Rule 1093(a).

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 exchange⁸ and, in particular, the requirements of Section 6(b)(5) of the Act.⁹ Specifically, the Commission finds that the proposed rule change 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 proposal eliminates the potentially burdensome requirements that are triggered when a non-SQT ROT executes more than 20% of its volume electronically, eliminates restrictions on non-SQT ROTs' use of orders to meet various in-person trading requirements, and makes clarifying and conforming changes to previously amended rule text.

⁸ 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).

⁹ 15 U.S.C. 78f(b)(5).

With respect to the elimination of the requirement that non-SQT ROTs stream quotes electronically if they transact more than 20% of their contract volume electronically, the Commission notes that the Exchange recently amended its rules to require ROTs (other than RSQTs and Remote Specialists) to execute a minimum of 1,000 contracts and 300 transactions on the Exchange each quarter.¹⁰ Given that a non-SQT ROT cannot control the size or frequency of crowd trades, the non-SQT ROT may have to use more electronic orders to meet this transaction requirement, making it more likely that such non-SQT ROT would trigger the 20% threshold for streaming quotes electronically. To the extent that a non-SQT ROT that meets this threshold may be unable or unwilling to invest the resources necessary for streaming quotes, and may exit open-outcry market making in that option rather than stream quotes, this may impact price improvement, quality of execution, and price discovery on the Exchange. The Commission believes it is reasonable to revise the quoting requirements for non-SQT ROTs accordingly to enable such non-SQT ROTs to continue making markets in open outcry, to the benefit of investors. In making this finding, the Commission notes that this proposal would affect a relatively small number of non-SQT ROTs, and that this change should not detract from the current electronic trading environment. Moreover, to the extent that this rule change imposes a continuous open outcry quoting obligation on all non-SQT ROTs, regardless of electronic transaction volume, the Commission notes that this proposal may potentially contribute to a more robust trading crowd in a given option.¹¹

¹⁰ See Securities Exchange Act Release No. 65644 (October 27, 2011), 76 FR 67786 (November 2, 2011) (SR-Phlx-2011-123). Transactions executed in the trading crowd where the contra-side is an ROT, however, do not count towards this requirement. See Rule 1014, Commentary .01.

¹¹ Currently, non-SQT ROTs that are under the 20% threshold quote in open outcry, while non-SQT ROTs that exceed the 20% threshold stream quotes electronically (or exit open-

Given that the Exchange is eliminating the continuous electronic quoting obligations for non-SQT ROTs, the Commission finds that it is consistent with the Act for the Exchange to eliminate a corresponding reference to this requirement in Rule 1093(a).

The Commission finds that the changes to Rule 1014, Commentary .13, and to the Options Floor Procedure Advice B-3 to permit non-SQT ROTs to use orders to meet in-person trading requirements are also consistent with the Act. Those changes are consistent with the recent changes to Commentary .01 to Rule 1014, which were approved by the Commission, to permit the use of orders entered in person to count towards the 80% in-person requirement of that Commentary.¹² As the Exchange noted in that rule change, non-SQT ROTs could have difficulty meeting the non-SQT ROT in-person trading requirements without counting orders entered electronically, given that non-SQT ROTs' ability to trade other than by the use of orders has substantially diminished over the years with the increasing prominence of electronic trading. The Commission finds that rationale equally applicable here. Similarly, the deletion of Rule 1014(b)(ii)(E)(1)(c) is also consistent with those changes to Commentary .01 to Rule 1014.

For the foregoing reasons, the Commission believes that the proposed rule change is consistent with the Act.

outcry market making in that option). This proposed change would impose the continuous open outcry obligation on all non-SQT ROTs.

¹² See Securities Exchange Act Release No. 65644 (October 27, 2011), 76 FR 67786 (November 2, 2011) (SR-Phlx-2011-123).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹³ that the proposed rule change (SR-Phlx-2012-40), as modified by Amendment No.1, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁴

Kevin M. O'Neill
Deputy Secretary

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ 17 CFR 200.30-3(a)(12).