

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72119; File No. SR-Phlx-2014-23)

May 7, 2014

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Notice of Filing of Proposed Rule Change Related to the Priority Afforded to In-Crowd Participants Respecting Crossing, Facilitation and Solicited Orders in Open Outcry Trading

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹, and Rule 19b-4 thereunder,² notice is hereby given that on April 23, 2014, NASDAQ OMX PHLX LLC (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “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 revise the priority afforded to in-crowd participants respecting crossing, facilitation and solicited orders in open outcry trading.

The text of the proposed rule change is available on the Exchange’s website at <http://nasdaqomxphlx.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

¹ 15 U.S.C. 78s(b)(1).

² 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

The Exchange proposes to amend Rule 1014, Commentary .05(c)(ii), to afford priority in open outcry trading to in-crowd participants over out-of-crowd Streaming Quote Traders (“SQTs”)³, Remote Specialists⁴, and Remote Streaming Quote Traders (“RSQTs”)⁵ and over out-

³ An SQT is defined in Exchange Rule 1014(b)(ii)(A) as a Registered Options Trader (“ROT”) who has received permission from the Exchange to generate and submit option quotations electronically in options to which such SQT is assigned. A ROT includes a SQT, a RSQT and a Non-SQT [sic], which by definition is neither a SQT or a RSQT. A Registered Options Trader is defined in Exchange Rule 1014(b) [sic] as 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).

⁴ A Remote Specialist is a qualified RSQT approved by the Exchange to function as a specialist in one or more options if the Exchange determines that it cannot allocate such options to a floor based specialist. A Remote Specialist has all the rights and obligations of a specialist, unless Exchange rules provide otherwise. See Exchange Rules 501 and 1020. See also, Securities Exchange Act Release No. 63717 (January 14, 2011), 76 FR 4141 (January 24, 2011) (SR-Phlx-2010-145).

⁵ A RSQT is defined in Exchange 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 RSQTO readiness requirements in Rule 507(a) [sic].

of-crowd broker-dealer limit orders on the limit order book (but not over public customer orders) in crossing⁶, facilitation⁷ and solicited⁸ orders, regardless of order size.

Deletion of 500 Contract Minimum Size

Currently, Commentary .05(c)(i) to Phlx Rule 1014 provides that, in the event that a Floor Broker or specialist⁹ presents a non-electronic order in which an RSQT is assigned or which is allocated to a Remote Specialist, and/or in which an SQT assigned in such option is not a crowd participant (collectively, “Non-Crowd Participants”), such Non-Crowd Participant may not participate in trades stemming from such a non-electronic order unless the non-electronic order is executed at the price quoted by the Non-Crowd Participant at the time of execution.

However, if the non-electronic order is executed at the price quoted by the Non-Crowd Participant, the Non-Crowd Participant may participate in the trade unless the order was a crossing, facilitation or solicited order with a size of at least 500 contracts on each side.¹⁰ If the order is a crossing, facilitation or solicited order with a size of at least 500 contracts on each side,

⁶ A crossing order occurs when an options Floor Broker holds orders to buy and sell the same option series. Such a Floor Broker may cross such orders, provided that the trading crowd is given an opportunity to bid and offer for such option series in accordance with Exchange rules. See Phlx Rule 1064(a).

⁷ A facilitation order occurs when an options Floor Broker holds an options order for a public customer and a contraside order. Such a Floor Broker may execute such orders as a facilitation order, provided that such Floor Broker proceeds in accordance with Exchange rules concerning facilitation orders. See Phlx Rule 1064(b).

⁸ A solicitation occurs whenever an order, other than a cross, is presented for execution in the trading crowd resulting from an away-from-the-crowd expression of interests to trade by one broker dealer to another. See Phlx Rule 1064(c).

⁹ A “Specialist” is an Exchange member who is registered as an options specialist pursuant to Rule 1020(a).

¹⁰ This in-crowd priority applies only to crossing, facilitation and solicited orders represented in open outcry, and does not apply to orders submitted electronically via the Exchange’s electronic options trading platform, to which other priority rules apply. See, e.g., Phlx Rules 1014(g)(vii) and (viii).

Commentary .05(c)(ii) gives priority to in-crowd participants (including, for purposes of Commentary .05(c)(ii) only, Floor Brokers) over Non-Crowd Participants and over out-of-crowd broker-dealer limit orders on the limit order book, but not over public customer orders.¹¹ Such orders are allocated in accordance with Exchange rules. By affording priority to in-crowd participants over Non-Crowd Participants and out-of-crowd broker-dealer limit orders in crossing, facilitation and solicited orders with a size of at least 500 contracts represented and executed in open outcry, the Exchange encourages order flow providers to send such orders to the Exchange.

The Exchange now proposes to further encourage order flow providers to send such orders to the Exchange by eliminating the 500 contract minimum order size from Commentary .05(c)(ii). As amended, the rule would afford priority to in-crowd participants over Non-Crowd Participants and out-of-crowd broker-dealer limit orders in crossing, facilitation and solicited orders regardless of the size of those orders. The current 500 contract minimum size requirement presents the possibility that one of the two sides of a Floor Brokered cross will not be fully executed on the trading floor. The size requirement was initially adopted by the Exchange in 2006 to foster the new electronic trading of options, by limiting participation of in-crowd participants in order to permit Non-Crowd Participants to participate in smaller (under five

¹¹ In keeping with current Exchange practices and rules, public customer limit orders represented in the trading crowd and resting on the limit order book have, and will continue to have, priority over all other participants and accordingly must be executed up to the aggregate size of such orders before any in-crowd participant is entitled to priority. Public customer orders on the limit order book that are eligible for execution are required to be executed before a Floor Broker may execute its order in the crowd and/or with a contra-side order it holds.

hundred contracts) Floor Broker crosses.¹² Today, electronic options trading is well-established and no longer requires such special rules and incentives to develop further.

The Exchange believes that by extending priority to in-crowd participants over Non-Crowd Participants and out-of-crowd broker-dealer limit orders in all crossing, facilitation and solicited orders represented and executed in open outcry, regardless of size, in-crowd participants such as Floor Brokers will be enabled to provide full service to their clients as they seek to execute such orders. By way of explanation, the size of orders given to Floor Brokers by member participants varies throughout the trading day, and generally those participants expect the same experience regardless of order size when evaluating priority of electronic quotes with respect to cross orders executed on the trading floor. Another options exchange does not have the same differentiation of priority for orders of fewer than 500 contracts¹³, and the different priority for orders with a size under 500 contracts has become an impediment to Phlx members soliciting orders. By removing the 500 contract minimum size distinction, the Exchange would permit Floor Brokers to access in-crowd liquidity for all order sizes, thereby providing full order execution service to their clients.

To illustrate the application of the revised rule, assume the following ranking of bids on Phlx:

RSQT market 1.00 bid x 1000

Out of crowd SQT market 1.00 bid x 200

In-crowd participants 1.00 bid x 100

¹² See Securities Exchange Act Release No. 54267 (August 3, 2006), 71 FR 45888 (August 10, 2006). See also Securities Exchange Act Release No. 64401 (May 4, 2011), 76 FR 27105 (May 10, 2011) (amending the rule to state that in-crowd participants in such orders also have priority over out-of-crowd broker-dealer limit orders on the limit order book).

¹³ See Chicago Board Options Exchange (“CBOE”) Rule 6.74, Crossing Orders.

Public customer order on the book 1.00 bid x 100

Broker-dealer order on the book 1.00 bid x 100

Assume a Floor Broker enters the trading crowd with a cross order. This cross order is an order to sell 10,000 contracts and a contra order to buy 10,000 contracts at 1.00. Under the current rule, after selling to all 1.00 public customer interest on the book (100 contracts) and to all 1.00 interest in the trading crowd (100 contracts), the Floor Broker is allowed to cross the remaining interest (9,800 contracts) at 1.00, with priority over RSQTs, out-of-crowd SQTs and broker-dealer limit orders on the book.¹⁴

If in this example, however, the Floor Broker's order to sell and contra order to buy at 1.00 were only for 400 contracts, the Floor Broker would be unable to cross the 200 contracts remaining interest after selling to all 1.00 public customer interest on the book (100) and to all 1.00 interest in the trading crowd (100 contracts) because the current rule gives the Floor Broker no priority over RSQTs, out-of-crowd SQTs and broker-dealer orders on the book respecting orders less than 500 contracts. The rule as revised would remove the limitation of the 500 contract minimum. Thus, under the revised rule, the Floor Broker in the example could enter the trading crowd with an order to sell 400 contracts and a contra order to buy 400 contracts at 1.00. After selling to all 1.00 public customer interest on the book (100) and to all 1.00 interest in the trading crowd (100 contracts), the Floor Broker would be allowed to cross the remaining interest (200 contracts) at 1.00, with priority over RSQTs, out-of-crowd SQTs and broker-dealer orders on the book.¹⁵

¹⁴ If the order in this paragraph's example were a facilitation order or a solicitation order, the resulting allocation of contracts would be no different.

¹⁵ As above, if the crossing order in this paragraph's example were a facilitation order or a solicited order, the resulting allocation of contracts would be no different.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the provisions of Section 6 of the Act,¹⁶ in general, and with Section 6(b)(5) of the Act,¹⁷ in particular, which requires that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, protect investors and the public interest, because it would encourage order flow providers to send additional crossing, facilitation and solicited orders to the Exchange, free of concerns that the order may not be completely executed by the trading crowd. As noted above, the size of orders given to Floor Brokers by member participants varies throughout the trading day, and generally those participants expect the same experience regardless of order size when evaluating priority of electronic quotes with respect to cross orders executed on the trading floor. By removing the 500 contract minimum size distinction, the Exchange would permit Floor Brokers to access in-crowd liquidity for all order sizes thereby enabling them to provide full service to member participants no matter the order size.

The Exchange believes that treating crossing, facilitation and solicitation orders of under 500 contracts on each side no differently from such orders of greater size creates no unfair disadvantage to investors. Elimination of the 500 contract minimum threshold size is just and equitable, because Non-Crowd Participants are not required to respond to a Floor Broker entering the crowd and requesting a market, whereas in-crowd participants are required to

¹⁶ 15 U.S.C. 78f.

¹⁷ 15 U.S.C. 78f(b)(5).

verbalize a market in response to such a request. The Exchange also believes that the proposal promotes just and equitable principles of trade by retaining public customer priority in all cases. The instant proposal will not affect public customer priority and the Exchange will continue to execute public customer limit orders up to their aggregate size at a particular price point.

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

The Exchange does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended. To the contrary, it should provide greater incentive for order flow providers to submit crossing, facilitation and solicited orders to the Exchange, thus enabling the Exchange to compete with another exchange that has similar rules in effect.¹⁸ Further, with respect to intra-market competition between crowd participants and Non-Crowd Participants, the proposed rule change will not result in any burden on competition. The proposed rule change should actually bolster competition. For example, assume the following market:

RSQT market 2.00 bid x 200

Out-of-crowd SQT market 2.00 bid x 200

In-crowd participants 1.70 bid x 100

Public customer order no bid on the book

Assume that a Floor Broker walks into the crowd with a cross order to buy 400 contracts at 2.00 and to sell 400 contracts at 2.00. Under the current rule, the Floor Broker would not have priority at 2.00 to allow the buy order of 400 contracts at 2.00 to participate. The seller would

¹⁸ See CBOE Rule 6.74 (which affords priority to in-crowd participants over out-of-crowd participants, including non-public customer orders on the limit order book, in all open outcry situations after public customers on the limit order book have been executed) and Securities Exchange Act Release No. 54726 (November 8, 2006), 71 FR 66810 (November 16, 2006) (SR-CBOE-2006-89).

forego the liquidity of the 2.00 bid the Floor Broker was handling and would need to sell 400 to the RSQT and out-of-crowd SQT utilizing their posted liquidity, and likely moving the market of the 2.00 bid lower after the trade. The rule as proposed would, instead, permit utilization of the liquidity of the Floor Broker's 2.00 bid by giving the 2.00 bid priority over the RSQT and out of crowd SQT thus keeping the posted liquidity intact at the existing bid of 2.00. The Exchange believes the residual 2.00 bidders would have extra incentive to compete by either maintaining their bid hoping to trade with additional selling interest or to increase their bid in order to vie for participation in the next sell order. The Exchange also believes that affording priority in to in-crowd participants regardless of size will attract additional smaller cross orders to the Exchange, creating an opportunity for in crowd market makers to compete for the smaller crosses as well.¹⁹

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will: (A) by order approve or disapprove such proposed rule change,

¹⁹ The Exchange notes that it is not proposing to eliminate the 500 contract minimum eligible order size in Rule 1064, Commentary .02. This provision entitles a Floor Broker to cross (after all public customer orders that were (1) on the limit order book and then (2) represented in the trading crowd at the time the market was established have been satisfied) 40% of the remaining contracts in an order of the eligible size, if the order traded at or between the best bid or offer given by the crowd in response to the Floor Broker's initial request for a market. See Rule 1064, Commentary .02(iii). This aspect of intra-market competition in the context of orders under 500 contracts is being maintained.

or (B) institute proceedings to determine whether the proposed rule change should be 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. The Commission requests comments, in particular, on the following aspects of the proposed rule change:

1. What are commenters' views on how, if at all, the proposed rule change would affect: (1) incentives to submit limit orders; (2) quoted spreads and quoted depth; and/or (3) transaction costs for orders below 500 contracts? Please elaborate.

2. What are commenters' views on how, if at all, orders for more than 500 contracts differ from orders for less than 500 contracts? Please elaborate. Are the underlying investors/traders or the investing/trading strategies different? Please explain. What types of investor or market participant, if any, would likely be significantly affected by the proposed rule change? Please explain.

3. Commenters are requested to provide empirical data and other factual support for their views.

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-2014-23 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-2014-23. 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, D.C. 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-Phlx-2014-23 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.²⁰

Kevin M. O'Neill
Deputy Secretary

²⁰ 17 CFR 200.30-3(a)(12).