

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-79345; File No. SR-Phlx-2016-82)

November 17, 2016

Self-Regulatory Organizations; NASDAQ PHLX LLC; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Adopt a New Exception in Exchange Rule 1000(f) for Sub-MPV Split-Price Orders

I. Introduction

On August 3, 2016, NASDAQ 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”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to provide an additional exception to the mandatory use of the Exchange’s Floor Broker Management System (“FBMS”) pursuant to Rule 1000(f)(iii) to permit Floor Brokers to execute certain sub-minimum price increment (“sub-MPV”) split-price orders in the trading crowd. The proposed rule change was published for comment in the Federal Register on August 22, 2016.<sup>3</sup> On October 3, 2016, the Commission extended the time period within which to 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 November 20, 2016.<sup>4</sup> The Commission received no comments on the proposal. This order institutes proceedings under Section 19(b)(2)(B) of the Act<sup>5</sup> to determine whether to disapprove the proposed rule change.

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

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

<sup>3</sup> See Securities Exchange Act Release No. 78593 (August 16, 2016), 81 FR 56724 (“Notice”).

<sup>4</sup> See Securities Exchange Act Release No. 79023 (October 3, 2016), 81 FR 69877 (October 7, 2016).

<sup>5</sup> 15 U.S.C. 78s(b)(2)(B).

## II. Description of the Proposed Rule Change

Currently, Phlx Rule 1000(f) requires that all Exchange options transactions be executed in one of the following three ways: “(i) [a]utomatically by the Exchange Trading System pursuant to Rule 1080 and other applicable options rules; (ii) by and among members in the Exchange’s options trading crowd none of whom is a Floor Broker; or (iii) through the Options [FBMS] for trades involving at least one Floor Broker.”<sup>6</sup> Although a Floor Broker may represent orders in the trading crowd, a Floor Broker is not permitted to execute an order in the trading crowd unless one of three exceptions applies.<sup>7</sup> The exceptions to the mandatory use of FBMS<sup>8</sup> are set forth in Phlx Rule 1000(f)(iii). These exceptions allow a Floor Broker to execute a transaction in the trading crowd (rather than through FBMS) if: (i) there is a problem with Exchange’s systems; (ii) the Floor Broker is executing the trade pursuant to Phlx Rule 1059 (“Accommodation Transactions”) or Phlx Rule 1079 (“Flex Index, Equity and Currency Options”); or (iii) the transaction involves a multi-leg order with more than 15 legs.<sup>9</sup>

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<sup>6</sup> See Phlx Rule 1000(f).

<sup>7</sup> See Phlx Rule 1000(f)(iii).

<sup>8</sup> The original FBMS (“FBMS 1”) began operating in 2005. The Exchange retired FBMS 1 on March 31, 2016 after operating it concurrently with the Exchange’s enhanced FBMS (“FBMS 2”), which was made available on March 7, 2014. As of March 31, 2016, FBMS 2 is available to all Floor Brokers in all options and is the only FBMS currently in use. The Exchange represents that it has contracted with a third-party to build an alternative system (“FBMS 3”) to replace FBMS 2, and anticipates that FBMS 3 will be ready by November 30, 2016. See Notice, supra note 3, at 56725.

<sup>9</sup> See Notice, supra note 3, at 56726; see also Phlx Rule 1000(f)(iii)(A)-(C). According to the Exchange, each time a Floor Broker uses one the current exceptions to Phlx Rule 1000(f)(iii), the Floor Broker is required by Phlx Rule 1063(e)(ii), to record the information required by Phlx Rule 1063(e)(i) on paper trade tickets. The Exchange further represents that a Floor Broker may only represent an order for execution that has been time stamped with the time of entry on the trading floor. In addition, according to the Exchange, once an execution occurs, the trade ticket must be stamped with the time of execution of such order. See Notice, supra note 3, at 56726.

Phlx Rule 1014(g)(i)(B) provides a priority rule regarding open outcry split price transactions in equity options and options overlying ETFs to permit a member who is responding to an order for at least 100 contracts who buys (sells) at least 50 contracts at a particular price to have priority over all other orders in purchasing (selling) up to an equivalent number of contracts of the same order at the next lower (higher) price without being required to yield to existing customer interest in the limit order book.<sup>10</sup> Absent Phlx Rule 1014(g)(i)(B), such orders would be required to yield priority. The Exchange states that “the purpose behind the split-price priority exception was ‘to bring about the execution of large orders, which by virtue of their size and the need to execute them at multiple prices may be difficult to execute without a limited exception to the priority rules.’”<sup>11</sup>

According to the Exchange, split-price orders are currently processed using either FBMS 2 or paper tickets, depending on whether the split-price order can be evenly split using simple calculations or whether the transaction involves non-even integers and sub-MPV price points, thus requiring a more complicated computation to determine the number of contracts to trade at two different price points.<sup>12</sup> The Exchange represents that FBMS 2 does not have the capability to calculate specific volumes at different prices for transactions resulting from split-price

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<sup>10</sup> See Notice, supra note 3, at 56726 (citing Securities Exchange Act Release No. 51820 (June 10, 2005), 70 FR 35759 (June 21, 2005) (SR-Phlx-2005-28)) (approving pilot). See also Securities Exchange Act Release No. 55993 (June 29, 2007), 72 FR 37301 (July 9, 2007) (SR-Phlx-2007-44) (permanent approval).

<sup>11</sup> See Notice, supra note 3, at 56726.

<sup>12</sup> See Notice, supra note 3, at 56726. Today, when the computation is more complicated, surveillance staff allows a Floor Broker to execute split-price orders involving non-even integers and sub-MPV price points in open outcry using paper tickets pursuant to Phlx Rule 1000(f)(iii)(A). See id.

orders.<sup>13</sup> To compensate for this system limitation, the Exchange is proposing to amend Phlx Rule 1000(f)(iii) to add a new exception from the mandatory use of FBMS that would expressly authorize Floor Brokers to execute certain split-price orders in the trading crowd.

Accordingly, the Exchange is proposing in Phlx Rule 1000(f)(iii)(D) to allow the following split-price orders to be executed in the trading crowd: (1) simple orders not expressed in the applicable sub-MPV and that cannot be evenly split into two whole numbers to create a price at the midpoint of the MPV; and (2) complex and multi-leg orders with at least one option leg with an odd-numbered volume that must trade at a sub-MPV price or one leg that qualifies under (1) above.<sup>14</sup>

The Exchange also proposes that, in addition to split-price orders executed pursuant to proposed Phlx Rule 1000(f)(iii)(D), Phlx surveillance staff would approve all executions submitted under Phlx Rule 1000(f)(iii) to validate that such executions abide by applicable priority and trade-through rules.<sup>15</sup> The Exchange also proposes to round prices if necessary to execute the trade at the MPV, but only to the benefit of a customer order, or, where multiple customer orders are involved, for the customer order that is earliest in time.<sup>16</sup>

### III. Proceedings to Determine Whether to Approve or Disapprove SR-Phlx-2016-82 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act,<sup>17</sup> to determine whether the proposed rule change should be disapproved. Institution of such

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<sup>13</sup> See Notice, supra note 3, at 56726.

<sup>14</sup> See Notice, supra note 3, at 56724.

<sup>15</sup> See proposed Phlx Rule 1000(f)(iii).

<sup>16</sup> See proposed Phlx Rule 1000(f)(iii); see also Notice, supra note 3, at 56727.

<sup>17</sup> 15 U.S.C. 78s(b)(2)(B).

proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change. 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 proposed rule change to inform the Commission's analysis of whether to approve or disapprove the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Act,<sup>18</sup> the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceeding to allow for additional analysis of, and input from commenters with respect to, the consistency of the proposed rule change with Section 6(b)(5) of the Act,<sup>19</sup> which requires that the rules of a national securities 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 not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers,<sup>20</sup> and with the Order Protection and Locked/Crossed Market Plan.<sup>21</sup>

Finally, under the Commission's rules of procedure, a self-regulatory organization that

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<sup>18</sup> Id. Section 19(b)(2)(B) of the Act also provides that proceedings to determine whether to disapprove a proposed rule change must be concluded within 180 days of the date of publication of the notice of the filing of the proposed rule change. The time for conclusion of the proceedings may be extended for up to 60 days if the Commission finds good cause for such extension and publishes its reasons for so finding. See id.

<sup>19</sup> 15 U.S.C. 78f(b)(5).

<sup>20</sup> 15 U.S.C. 78f(b)(5).

<sup>21</sup> The Options Order Protection and Locked/Crossed Markets Plan is available at [http://www.optionsclearing.com/components/docs/clearing/services/options\\_order\\_protection\\_plan.pdf](http://www.optionsclearing.com/components/docs/clearing/services/options_order_protection_plan.pdf).

proposes to amend its rules bears the burden of demonstrating that its proposal is consistent with the Act.<sup>22</sup> In this regard:

the description of the proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with the applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding. Any failure of the self-regulatory organization to provide the information elicited by Form 19b-4 may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Exchange Act and the rules and regulations thereunder that are applicable to the self-regulation organization.<sup>23</sup>

#### 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 issues identified above, as well as any other concerns they may have with respect to the proposed rule change. In particular, the Commission invites written views of interested persons concerning whether the proposed rule change is consistent with Section 6(b)(5) 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 which would be facilitated by an oral 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.<sup>24</sup>

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

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<sup>22</sup> Rule 700(b)(3), 17 CFR 201.700(b)(3).

<sup>23</sup> Id.

<sup>24</sup> 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, 94<sup>th</sup> Cong., 1<sup>st</sup> Sess. 30 (1975).

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]. The Commission asks that commenters address the sufficiency and merit of the Exchange's statements in support of the proposed rule change, in addition to any other comments they may wish to submit about the proposed rule change. The Commission notes that Phlx states that "rounding of prices is used only where necessary to execute a trade at the MPV, and only to the benefit of a customer order. . . ." <sup>25</sup> The Commission seeks commenters' views on the Exchange's statements, which are set forth in the Notice, <sup>26</sup> regarding how the Exchange would round prices for split-price orders, particularly when no customer orders are involved, in addition to any other comments they may wish to submit about the proposed rule change. The Commission seeks comment on whether this aspect of the proposal is consistent with Section 6(b)(5), which requires, among other things, that a proposed rule change not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers. <sup>27</sup>

The Commission is concerned that the Exchange has not made clear what the time of execution would be for split-price orders executed manually by Floor Brokers pursuant to the exception proposed in Phlx Rule 1000(f)(iii)(D) or how Floor Brokers would use paper tickets to execute split-price orders under the proposed exception. The Commission seeks commenters' views on the sufficiency of the Exchange's statements regarding the execution of a split-price order by a Floor Broker pursuant to the proposed exception under Phlx Rule 1000(f)(iii)(D). In addition, the Commission seeks comment on whether the proposed rule change is consistent with

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<sup>25</sup> See Notice, supra note 3, at 56724.

<sup>26</sup> See Notice, supra note 3.

<sup>27</sup> 15 U.S.C.78f(b)(5).

the Options Order Protection and Locked/Crossed Market Plan.

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-2016-82 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-2016-82](#). The 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-2016-82 and should be submitted on or before [insert date 21 days from date of publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>28</sup>

Brent J. Fields  
Secretary

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<sup>28</sup> 17 CFR 200.30-3(a)(57).