

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-82012; File No. SR-Phlx-2017-93)

November 3, 2017

Self-Regulatory Organizations; Nasdaq PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend Rule 1080(p)(2) to Enhance Anti-Internalization Functionality

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 2, 2017, Nasdaq PHLX LLC (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III, 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 Rule 1080(p)(2) to enhance anti-internalization functionality.

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

The purpose of the proposed rule change is to enhance the anti-internalization (“AIQ”) functionality provided to Specialists and Registered Options Traders (“ROTs”) (collectively, “market makers”)<sup>3</sup> on the Exchange by giving members the flexibility to choose to have this protection apply at the badge level (i.e., existing functionality), at the Exchange account level, or at the member firm level. The Exchange believes that this enhancement will provide helpful flexibility for market making firms that wish to prevent trading against all quotes and orders entered by their firm, or Exchange account, instead of just quotes and orders that are entered under the same badge.

Currently, the Exchange provides mandatory AIQ functionality whereby quotes and orders entered by market makers using the same Phlx badge are not executed against quotes and orders entered on the opposite side of the market using the same badge.<sup>4</sup> When a quote or order entered by a market maker would trade with other quotes or orders from the same badge, the trading system cancels the resting quote or order back to the entering party prior to execution.<sup>5</sup> AIQ assists market makers in reducing trading costs from unwanted executions potentially

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<sup>3</sup> Specialists and ROTs are considered market makers on Phlx. See Rule 1014.

<sup>4</sup> See Rule 1080(p).

<sup>5</sup> Id. A quote or order entered by a market maker only triggers AIQ when it would trade with other quotes or orders from the same market maker. Thus, an incoming quote or order entered by a market maker may interact with other interest with priority on the book prior to triggering AIQ. After AIQ is triggered, the incoming quote or order may continue to trade with resting interest from other participants.

resulting from the interaction of executable buy and sell trading interest from the same firm when performing the same market making function.

Today, this protection prevents market makers from trading against their own quotes and orders at the badge level. The proposed enhancement to this functionality would allow members to choose to have this protection applied at the badge level as implemented today, at the Exchange account level, or at the member firm level. If members choose to have this protection applied at the Exchange account level, AIQ would prohibit quotes and orders from different badges associated with the same Exchange account from trading against one another. Similarly, if the members choose to have this protection applied at the member firm level, AIQ would prohibit quotes and orders from different badges within the member firm from trading against one another. Members that do not select to have this protection applied at the Exchange account level or member firm level will have their AIQ protection defaulted to the badge level protection applied today. The Exchange believes that the proposed AIQ enhancement will provide members with more tailored self-trade functionality that allows them to manage their trading as appropriate based on the members' business needs. While the Exchange believes that some firms will want to restrict AIQ to trading against interest from the same badge – i.e., as implemented today – the Exchange believes that other firms will find it helpful to be able to configure AIQ to apply at the Exchange account level or at the member firm level so that they are protected regardless of which badge the order or quote originated from. Similar flexibility is offered on the Exchange's affiliate, the Nasdaq Options Market (“NOM”),<sup>6</sup> and also on the BATS BZX Exchange (“BZX”), which provides members the ability to apply Match Trade Prevention

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<sup>6</sup> See NOM Chapter VI, Sec. 10. See also Securities Exchange Act Release No. 81171 (July 19, 2017), 82 FR 34557 (July 25, 2017) (SR-Nasdaq-2017-069).

(“MTP”) modifiers – i.e., BZX’s version of self-trade protection – based on MPID, Exchange Member, trading group, or Exchange Sponsored Participant identifiers.<sup>7</sup>

The examples below illustrate how AIQ would operate based on the badge level protection, the Exchange account level, or for members that choose to apply AIQ at the member firm level:

**Example 1**

1. Member ABC (badge 123A & 555B) with AIQ configured at the badge level
2. 123A Quote: \$1.00 (5) x \$1.10 (20)
3. 555B Buy Order entered for 10 contracts at \$1.10
4. 555B Buy Order executes 10 contracts against 123A Quote. 123A and 555B are permitted trade against one another because Member ABC has configured AIQ to apply at the badge level. This is the same as existing functionality.

**Example 2**

1. Member ABC (Account 999 with badges 123A and 555B, and Account 888 with badge 789A) with AIQ configured at the Exchange account level
2. 123A Quote: \$1.00 (5) x \$1.10 (20)
3. 789A Quote: \$1.05(10) x \$1.10 (20)
4. 555B Buy Order entered for 30 contracts at \$1.10
5. 555B Buy Order executes against 789A Quote but 555B Buy Order does not execute against 123A Quote. AIQ purges the 123A Quote and the remaining contracts of the 555B Buy Order rests on the book at \$1.10. 123A and 555B are not permitted trade against one another because Member ABC has configured AIQ to apply at the Exchange

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<sup>7</sup> See BZX Rule 21.1(g).

account level. This is new functionality as the member has opted to have AIQ operate at the Exchange account level.

### **Example 3**

1. Same as Example 2 above but Member ABC has AIQ configured at the member level.
2. AIQ purges the 123A Quote and the 789A Quote and the 555B Buy Order rests on the book at \$1.10. This is new functionality as the member has opted to have AIQ operate at the member level.

### **Implementation**

The Exchange proposes to launch the AIQ functionality described in this proposed rule change in either Q4 2017 or Q1 2018. The Exchange will announce the implementation date of this functionality in an Options Trader Alert issued to members prior to the launch date.

#### **2. Statutory Basis**

The Exchange believes that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange, and, in particular, with the requirements of Section 6(b) of the Act.<sup>8</sup> In particular, the proposal is consistent with Section 6(b)(5) of the Act,<sup>9</sup> because it is designed to promote just and equitable principles of trade, remove impediments to and perfect the mechanisms of a free and open market and a national market system and, in general, to protect investors and the public interest.

The Exchange believes that the proposed rule change is consistent with the protection of investors and the public interest as it is designed to provide Phlx market makers with additional flexibility with respect to how to implement self-trade protections provided by AIQ. Currently,

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<sup>8</sup> 15 U.S.C. 78f(b).

<sup>9</sup> 15 U.S.C. 78f(b)(5).

all market makers are provided functionality that prevents quotes and orders from one badge from trading with quotes and orders from the same badge. This allows market makers to better manage their order flow and prevent undesirable executions where the market maker, using the same badge, would be on both sides of the trade. While this functionality is helpful to our members, some members would prefer not to trade with quotes and orders entered by different badges within the same Exchange account or member. Thus, the Exchange is proposing to provide members with flexibility with respect to how AIQ is implemented. While members that like the current functionality can continue to use it, members who would prefer to prevent self-trades across different badges within the same Exchange account or at the member level will now be provided with functionality that lets them do this. Similar flexibility is offered on both NOM and BZX.<sup>10</sup> The Exchange believes that flexibility to apply AIQ at the Exchange account or member firm level would be useful for Phlx members too. The Exchange believes that the proposed rule change is designed to promote just and equitable principles of trade and will remove impediments to and perfect the mechanisms of a free and open market as it will further enhance self-trade protections provided to market makers similar to those protections provided on other markets. This functionality does not relieve or otherwise modify the duty of best execution owed to orders received from public customers.

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

In accordance with Section 6(b)(8) of the Act,<sup>11</sup> the Exchange does not believe that the proposed rule change will impose any burden on intermarket or intramarket competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule change is designed to enhance AIQ functionality provided to Exchange market makers, and will benefit

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<sup>10</sup> See supra notes 6-7.

<sup>11</sup> 15 U.S.C. 78f(b)(8).

members that wish to protect their quotes and orders against trading with other quotes and orders within the same Exchange account or member, rather than the more limited badge standard applied today. The new functionality, which provides similar flexibility to that offered on both NOM and BZX, is also completely voluntary, and members that wish to use the current functionality can also continue to do so. The Exchange does not believe that providing more flexibility to members will have any significant impact on competition. In fact, the Exchange believes that the proposed rule change is evidence of the competitive environment in the options industry where exchanges must continually improve their offerings to maintain competitive standing.

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>12</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>13</sup>

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

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<sup>12</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>13</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file 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.

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-2017-93 on the subject line.

##### Paper Comments:

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

All submissions should refer to File Number SR-Phlx-2017-93. 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-2017-93 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>14</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>14</sup> 17 CFR 200.30-3(a)(12).