

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-82045; File No. SR-Phlx-2017-87)

November 9, 2017

Self-Regulatory Organizations; Nasdaq PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend Rule 1059, Accommodation Transactions

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 October 26, 2017, Nasdaq PHLX LLC (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “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 1059, Accommodation Transactions.

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

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

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

the places specified in 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 1059, Accommodation Transactions, which provides for cabinet trading<sup>3</sup> and is sometimes referred to as the “cabinet rule,” to delete outdated language in Rule 1059(a) relating to the role of specialists in cabinet trading, and to add to Rule 1059(a) a description of procedures that are currently followed in cabinet trading on the Exchange’s trading floor, to reflect actual practice.

Exchange Rule 1059, Accommodation Transactions, sets forth specific procedures for engaging in cabinet trades. Rule 1059(a) currently provides that the specialist registered in each class of option contracts shall supervise the operation of the cabinet for that class, and that all orders placed in the cabinet are assigned priority based upon the sequence in which such orders are received by the specialist. It states that all closing bids and offers are to be submitted to the specialist in writing, and that the specialist effects all closing cabinet transactions by matching such orders placed with him. The rule provides that bids or offers on orders to open for the accounts of customer, firm, specialists and Registered Options Traders (“ROTs”) can be made at \$1 per option

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<sup>3</sup> An “accommodation” or “cabinet” trade refers to trades in listed options on the Exchange that are worthless or not actively traded, often times conducted to establish tax losses. Cabinet or accommodation trading of option contracts is intended to accommodate persons wishing to effect closing transactions in those series of options dealt in on the Exchange for which there is no auction market. A cabinet trade is a transaction in which the per-contract value of the cabinet trade is less than the per-contract value of a trade at the specified minimum increment for the option contract.

contract, but that such orders cannot be placed in, and must yield to, all orders in the cabinet. Rule 1059(a) currently states that specialists shall effect all cabinet transactions by matching closing purchase or sale orders which are placed in the cabinet or, provided there is no matching closing purchase or sale order in the cabinet, by matching a closing purchase or sale order in the cabinet with an opening purchase or sale order. The rule states that all cabinet transactions are to be reported to the Exchange following the close of each business day.<sup>4</sup>

Rule 1059(a), which prescribes the roles described above for the specialist in executing cabinet trades, is inconsistent with procedures currently followed in the execution of these trades. Because remote trading has become common in recent years, such that specialists are no longer present on the trading floor in all options, the procedures used to execute cabinet trades have evolved. Additionally, with the migration of the Exchange to a new electronic trading system (“Phlx XL II”) in 2009, the role of the

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<sup>4</sup> Rule 1059(b) provides that any (i) member, (ii) member organization, or (iii) other person who is a non-member broker or dealer and who directly or indirectly controlled, is controlled by, or is under common control with, a member or member organization (any such other person being referred to as an affiliated person) may effect any transaction as principal in the over-the-counter market in any class of option contracts listed on the Exchange for a premium not in excess of \$1.00 per contract. The Exchange is proposing no changes to Rule 1059(b). The Commentary to Rule 1059 describes an existing pilot program to allow transactions to take place in open outcry at a price of at least \$0 but less than \$1 per option contract. These lower priced transactions are traded pursuant to the same procedures applicable to \$1 cabinet trades, except that pursuant to the pilot program (i) bids and offers for opening transactions are only permitted to accommodate closing transactions in order to limit use of the procedure to liquidations of existing positions, and (ii) the procedures are also made available for trading in options participating in the Penny Pilot Program. The pilot program is in effect until January 5, 2018, and the Exchange intends to file a proposed rule change to make the pilot program permanent before that date. The Exchange is proposing no changes to the Rule 1059 Commentary or the pilot program at this time.

Exchange specialist changed.<sup>5</sup> Specialists no longer handle orders for other market participants in their capacity as specialists under the Exchange's rules for electronic trading.

Accordingly, the Exchange proposes to delete a number of provisions of Rule 1059(a) which presume the participation of a specialist in every cabinet trade. First, the Exchange proposes to delete Rule 1059(a)(ii) which states that the specialist shall supervise the operation of the cabinet for that class, as well as the requirement in Rule 1059(a)(iii) that only closing limit orders at a price of \$1 per option contract for the accounts of customer, firm, specialists and ROTs may be placed in the cabinet and that such orders be submitted to the specialist in writing. Next, it proposes to delete Rule 1059(a)(iv) dealing with the priority of orders received by the specialist and Rule 1059(a)(v), which states that all closing bids and offers must be submitted to the specialist in writing, and that the specialist shall effect all closing cabinet transactions by matching such orders placed with him. The provision in Rule 1059(a)(v) stating that bids or offers on orders to open for the accounts of customer, firm, specialists and ROTs may be made at \$1 per option contract, but that such orders may not be placed in and must yield to all orders in the cabinet, is also proposed to be deleted. Finally, the Exchange proposes to delete Rule 1059(a)(vi) which states that specialists shall effect all cabinet transactions by matching closing purchase or sale orders which have been placed in the

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<sup>5</sup> In May 2009, the Exchange enhanced the options trading system and adopted corresponding rules referring to it as "Phlx XL II." See Securities Exchange Act Release No. 59995 (May 28, 2009), 74 FR 26750 (June 3, 2009) (SR-Phlx-2009-32). Thereafter, the Exchange submitted a number of filings updating various rules and deleting obsolete provisions. See Securities Exchange Act Release Nos. 61397 (January 22, 2010), 75 FR 4893 (January 29, 2010) (SR-Phlx-2010-07); 63036 (October 4, 2010), 75 FR 62621 (October 12, 2010) (SR-Phlx-2010-131); and 67469 (July 19, 2012), 77 FR 43633 (July 25, 2012) (SR-Phlx-2012-92).

cabinet or, provided there is no matching closing purchase or sale order in the cabinet, by matching a closing purchase or sale order in the cabinet with an opening purchase or sale order.

The Exchange proposes to reorganize the rule for clarity and to add new language setting forth procedures that are currently followed on the trading floor to execute cabinet orders under Rule 1059. Rule 1059(a) would be revised to define the term “cabinet order” as a closing limit order at a price of \$1 per option contract for the account of a customer, firm, specialist or ROT. This new definition is consistent with current Rule 1059(a)(iii) which, while not a definition, provides that only closing limit orders at a price of \$1 per option contract for the accounts of customer, firm, specialists and ROTs may be placed in the cabinet. Rule 1059(a) would also specify that an opening order is not a “cabinet order” but may in certain cases be matched with a cabinet order pursuant to subsection (a)(iii) (as proposed to be amended). The rule would specify that only Floor Brokers may represent cabinet orders.

New Rule 1059(a)(ii) would be added, to provide that cabinet orders may be submitted to Floor Brokers and represented by them in the designated trading crowd of the option class and that Floor Brokers must use the designated cabinet transaction forms provided by the Exchange to document receipt of a cabinet order and the execution of a cabinet transaction. The new language would specify that Rule 1063(e)(i) shall not apply to orders placed in the cabinet or executed in the cabinet.<sup>6</sup>

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<sup>6</sup> Rule 1063(e)(i) provides for the use on the trading floor of the Options Floor Broker Management System. The proposed new language is consistent with Rule 1000(f)(iii)(B), which currently states that Floor Brokers can execute cabinet trades in the options trading crowd pursuant to Rule 1059, rather than by using the Floor Broker Management System. See Securities Exchange Act Release No.

The Exchange proposes to add new Rule 1059(a)(iii), which specifies the procedures to be followed by the Floor Broker and other trading crowd participants to execute cabinet orders in three different scenarios. In each case, the Floor Broker would be required to act in the presence of at least one market-maker and NASDAQ Market Regulation Floor Surveillance.

Rule 1059(a)(iii)(A) governs cases where a Floor Broker holds a cabinet order but does not also hold contra-side interest. In that case, the Floor Broker shall announce the terms of the cabinet order to the trading crowd to solicit interest to participate on the closing position. All matching cabinet orders shall be assigned priority based upon the sequence in which such orders are received by the Floor Broker. If there is no matching cabinet order, the Floor Broker may match the cabinet order with a matching opening buy or sell limit order priced at \$1 per option contract. If there is no matching cabinet order or opening order, the Floor Broker may seek matching bids or offers for accounts of specialists and ROTs. Specialists and ROTs can only participate after all other orders have been matched.

Rule 1059(a)(iii)(B) governs cases where a Floor Broker holds a cabinet order and also a contra-side cabinet order. In that situation, the rule would require the Floor Broker to announce the terms of the cabinet orders to the trading crowd. The cabinet orders shall then be immediately crossed by the Floor Broker.

Finally, Rule 1059(a)(iii)(C) applies where a Floor Broker holds both a cabinet order and a contra-side opening order. In that situation, the Floor Broker is required to

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69471 (April 29, 2013), 78 FR 26096 (May 3, 2013) (Order Approving Proposed Rule Change To Enhance the Functionality Offered on the Options Floor Broker Management System (“FBMS”) by, Among Other Things, Automating Functions Currently Performed by Floor Brokers), at footnote 9.

announce the terms of the cabinet order to the trading crowd. If there is a matching cabinet order, the Floor Broker shall match the two cabinet orders. If there is no matching cabinet order, the cabinet order shall then be immediately crossed by the Floor Broker with the opening order held by the Floor Broker.

The proposed amendments describing the updated cabinet trading procedures will change the current cabinet priority rules in some respects. Currently, specialists match all orders represented by all floor brokers on the floor, based first on time, then on opening vs. closing. The specialist is required to assign priority to all orders placed in the cabinet based upon the sequence in which such orders are received by the specialist. The specialist is then to match cabinet orders first against matching cabinet orders, and second, if there is no matching cabinet order, against a matching opening order.

The proposed priority rules focus on the cabinet order at the time it is represented by a floor broker in the trading crowd. Thus, as proposed, each floor broker holding a cabinet order only would be required to assign priority to cabinet orders he holds based upon the sequence in which he receives such orders, consistent with the current rule's requirement for specialists, but would not be required to cede priority to a cabinet order represented in the crowd at an earlier time by another Floor Broker.

The floor broker is then to assign matching cabinet orders from the crowd based upon the sequence in which the orders are received by that floor broker representing such order. For example, the "Floor Broker A" receives a cabinet order to buy 500 contracts and represents to the trading crowd. At the time of representation to the crowd, "Floor Broker B" has a matching cabinet order for 250 contracts and "Floor Broker C" enters the trading crowd after "Floor Broker B" with a matching cabinet order for 500 contracts.

“Floor Broker A” then proceeds to match his 500 contracts to buy cabinet order with the matching cabinet order from “Floor Broker B” for 250 contracts and matching the balance of 250 contracts with “Floor Broker C”. The Floor Broker matched the cabinet orders based on the sequence in which the orders were received in the crowd at the time the cabinet order was represented. If there are no matching cabinet orders from the crowd, the floor broker may match the cabinet order with a matching opening order from the crowd. If however the floor broker holds both a cabinet order and a contra side cabinet order, the floor broker would be required to immediately cross those orders after announcing their terms in the crowd, regardless of cabinet orders held by other floor brokers. This represents a change to the priority scheme under the current cabinet rule.

The Exchange is proposing a number of additional, minor changes to Rule 1059. New Rule 1059(a)(iv) would require the Floor Broker, once the cabinet order has been either crossed or matched, to submit the designated cabinet form to the Nasdaq Market Operations staff for clearance and reporting at the close of the business day. Current Rule 1059(a)(viii), which provides that all cabinet transactions shall be reported to the Exchange following the close of each business day, would be deleted. Finally, Rule 1059(a)(vii) would be redesignated as Rule 1059(a)(v) and would be revised to delete an erroneous and outdated cross-reference to Rule 1038, previously deleted from the rulebook.<sup>7</sup>

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the

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<sup>7</sup> No changes are proposed to be made to Rule 1059(b) or to the Commentary.



Act,<sup>8</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>9</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, by providing detailed procedures for cabinet trades without the participation of specialists. As noted above, specialists are no longer common on the trading floor. By adopting the proposed amendments to the cabinet rules detailed above, the Exchange will maintain the ability for market participants to close out positions in which the value of the contract is less than the value of the contract at the minimum increment. The proposed rule change will conform the description of procedures in Rule 1059 to actual current practice. The proposed rule change permits market participants to continue to execute cabinet trades on the Exchange, even without the participation of specialists. The changes to the priority in which cabinet rules are executed are necessary in view of the new procedures for execution of cabinet trades without the participation of a specialist. The proposed amendments promote just and equitable principles of trade by setting forth priority rules for trade executions, and by requiring use of Exchange designated cabinet transaction forms to record information and the submission of the forms to Nasdaq Market Operations staff for the clearance and reporting of the cabinet trades.

The role of the specialist has changed on the Exchange, and specialists are no longer present in all options classes on the Exchange's trading floor. The proposed rule change would maintain market participants' ability to execute cabinet transactions on the

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

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

Exchange's trading floor, in an open manner and in compliance with new procedures specified in the revised rule.

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. The proposed rule change permits market participants to continue to execute cabinet trades on the Exchange, even without the participation of specialists. The proposed amendments will apply to all Floor Brokers equally and in the same way. Phlx notes that market participants may also execute cabinet transactions on other exchanges.

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>10</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>11</sup>

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<sup>10</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>11</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.

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-2017-87 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-2017-87. 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-2017-87 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>12</sup>

Eduardo A. Aleman  
Assistant Secretary

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