

**SECURITIES AND EXCHANGE COMMISSION**  
(Release No. 34-79373; File No. SR-Phlx-2016-116)

November 22, 2016

Self-Regulatory Organizations; NASDAQ PHLX LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Amend the Allocation of Directed Complex Orders

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 16, 2016, NASDAQ PHLX LLC (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“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 amend the allocation of Directed Orders as it relates to Complex Orders.<sup>3</sup>

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.

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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> A Complex Order is any order involving the simultaneous purchase and/or sale of two or more different options series in the same underlying security, priced at a net debit or credit based on the relative prices of the individual components, for the same account, for the purpose of executing a particular investment strategy. Furthermore, a Complex Order can also be a stock-option order, which is an order to buy or sell a stated number of units of an underlying stock or ETF coupled with the purchase or sale of options contract(s). See Exchange Rule 1098.

## **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 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 this rule change is to amend the allocation of Directed Orders at Rule 1014(g)(viii) to except Directed Complex Orders from receiving a participation guarantee. A Directed Order is any order (other than a stop or stop-limit order as defined in Rule 1066) to buy or sell which has been directed to a particular specialist, RSQT, or SQT by an Order Flow Provider (“OFP”).<sup>4</sup>

In May 2005 the Exchange adopted rules for Phlx XL that permit Exchange specialists, Streaming Quote Traders (“SQTs”)<sup>5</sup>, and Remote Streaming Quote Traders

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<sup>4</sup> Phlx Rule 1080(1)(i)(A).

<sup>5</sup> An SQT is an 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. An SQT may only submit such quotations while such SQT is physically present on the floor of the Exchange. An SQT may only trade in a market making capacity in classes of options in which the SQT is assigned. See Phlx Rule 1014(b)(ii)(A). A ROT is defined in Exchange Rule 1014(b) 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. A ROT includes SQTs and RSQTs as well as on and off-floor ROTS.

(“RSQTs”)<sup>6</sup> to receive Directed Orders, and to provide a participation guarantee to specialists, SQTs and RSQTs that receive Directed Orders.<sup>7</sup> Pursuant to Phlx Rule 1080(l)(ii) a Directed Order will be automatically executed and allocated to those quotations and orders at the National Best Bid or Offer (“NBBO”) when the Exchange’s disseminated price is at the NBBO at the time of receipt of the Directed Orders and the member or member organization is quoting at the Exchange’s disseminated price.

At this time, the Exchange is excepting Directed Complex Orders from a Directed Orders allocation because the Exchange’s system cannot prevent a participation allocation for Directed Complex Orders when the Exchange’s disseminated best bid or offer is not at the NBBO when the Directed Complex Order is received. The Exchange may offer a participation allocation for Directed Complex Orders at a later date by filing a proposed rule change with the Commission, after it has a limitation in place to systematically enforce Rule 1080(l)(ii) with respect to Directed Complex Orders. With this proposal, Complex Orders may continue to be marked as Directed Orders, but these orders will not receive a participation allocation pursuant to Exchange Rule 1014(g)(viii). Instead, these Complex Orders will be allocated pursuant to Exchange Rule 1014(g)(vii).

Today, as noted above, a Directed Order is defined in 1080(1)(i)(A) as any order (other than a stop or stop-limit order as defined in Rule 1066) to buy or sell which has

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<sup>6</sup> An RSQT is an ROT that is a member affiliated with a Remote Streaming Quote Trader Organization 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. See Phlx Rule 1014(b)(ii)(B).

<sup>7</sup> See Securities Exchange Act Release No. 51759 (May 27, 2005), 70 FR 32860 (June 6, 2005). See also Phlx Rule 1014(g)(viii) (setting forth the automatic trade allocation algorithm for Directed Orders).

been directed to a particular specialist, RSQT, or SQT by an OFP. Pursuant to Exchange Rule 1080(l), OFPs must transmit Directed Orders to a particular specialist, SQT, or RSQT electronically. If the Exchange's disseminated best bid or offer is at the NBBO when the Directed Order is received, the Directed Order is automatically executed on Phlx XL and allocated to the orders and quotes represented in the Exchange's quotation. A Directed Specialist, SQT, or RSQT will receive a participation allocation pursuant to Exchange Rule 1014(g)(viii) if the Directed Specialist, SQT, or RSQT was quoting at the NBBO at the time that the Directed Order was received.<sup>8</sup> Otherwise, the automatic execution will be allocated to those quotations and orders at the NBBO pursuant to Exchange Rule 1014(g)(vii).<sup>9</sup> Directed Orders can be sent not only on behalf of public customers but also on behalf of broker dealers. Directed Orders are limited to orders sent on an agency basis by an OFP and not on behalf of the sender's proprietary account. To qualify as a Directed Order, an order must be delivered to the Exchange electronically. Today, both simple and Complex Orders may be submitted to the Exchange as Directed Orders and receive an allocation.<sup>10</sup>

The Exchange's proposal would result in Directed Complex Orders not receiving a participation guarantee as a Directed Order pursuant to Exchange Rule 1014(g)(viii).

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<sup>8</sup> See Exchange Rule 1080(l)(ii).

<sup>9</sup> See Exchange Rule 1080(l)(iii).

<sup>10</sup> Today, Directed Complex Orders are eligible to receive a Directed Order allocation only if it is legging into the simple order book (i.e. the individual components of the Complex Order are trading against simple orders or quotes). Complex Orders which are stock-option orders are not eligible to leg into the simple order book and therefore not eligible to receive a Directed Order allocation. See Phlx Rule 1098(c)(i).

Directed Simple Orders would continue to receive a participation guarantee pursuant to Rule 1014(g)(viii).

The Exchange believes that Directed Orders reward specialists, SQTs, and RSQTs for actively engaging in marketing activities and establishing relationships with Order Flow Providers (“OFPs”) that generate Directed Orders sent to the Exchange by such OFPs. The Exchange believes that continuing to provide a participation guarantee for simple orders which are directed, will continue to result in additional order flow to the Exchange, thus adding depth and liquidity to the Exchange’s markets, and enabling the Exchange to continue to compete effectively with other options exchanges for order flow. The Exchange also believes that no longer providing a participation guarantee when a Directed Complex Order executes will not adversely impact the market or the opportunity for such orders to execute. Directed Complex Orders will continue to be provided the same access to liquidity on the Exchange as today. The Exchange intends to discontinue the participation allocation prior to December 1, 2016.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>11</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>12</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 continuing to reward specialists, SQTs, and RSQTs transacting simple options on Phlx XL with a participation guarantee in trades involving Directed Orders to encourage the capture of

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

<sup>12</sup> 15 U.S.C. 78f(b)(5).

order flow on the Exchange. With this proposal, the Exchange would not permit a participation guarantee for Directed Complex Orders which are submitted to the Exchange, nonetheless the Exchange believes continuing to provide a participation guarantee for simple orders to be directed will continue to result in additional order flow to the Exchange, thus adding depth and liquidity to the Exchange's markets, and enabling the Exchange to continue to compete effectively with other options exchanges for order flow. Today, the system cannot prevent a participation allocation for Directed Complex Orders when the Exchange's disseminated best bid or offer is not at the NBBO when the Directed Order is received. The Exchange believes that it is consistent with the Act to not offer the participation allocation for the Directed Complex Orders without a system limitation in place that would prevent a Directed Specialist, SQT or RSQT from receiving a Directed Complex Order allocation pursuant to Exchange Rule 1014(g)(viii) unless the Directed Specialist, SQT or RSQT is quoting at the NBBO at the time the Directed Complex Order is received as required by Exchange Rule 1080(l)(ii). The Exchange intended the Directed Order allocation to reward members and member organizations that are quoting at the NBBO when a Directed Order is received. The Exchange believes that such a system limitation would need to be in place to ensure that the Exchange's Rules related to Directed Complex Order operate as intended. Since the Exchange does not have the system limitation in place today, it would not function as intended.

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. With this proposal, the Exchange would not provide a participation guarantee for

Directed Complex Orders which are submitted to the Exchange. All Phlx members and member organizations would continue to receive a participation guarantee for simple orders directed to the Exchange but not receive a participation guarantee for Complex Orders that are directed.

B. 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 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, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>13</sup> and Rule 19b-4(f)(6) thereunder.<sup>14</sup>

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative prior to 30 days after the date of filing. However, Rule 19b-4(f)(6)(iii)<sup>15</sup> permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has asked the Commission to waive the 30-day operative delay to allow the proposal to become operative prior to

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<sup>13</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>14</sup> 17 CFR 240.19b-4(f)(6). As required under Rule 19b-4(f)(6)(iii), the Exchange provided the Commission with written notice of its intent to file the proposed rule change, along with a brief description and the text of 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.

<sup>15</sup> 17 CFR 19b-4(f)(6)(iii).

December 1, 2016.<sup>16</sup> As discussed above, Phlx Rule 1080(l)(ii) allows a Directed Specialist, SQT, or RSQT to receive a participation allocation pursuant to Phlx Rule 1014(g)(viii) if the Directed Specialist, SQT, or RSQT was quoting at the NBBO at the time the Directed Order was received. The Exchange notes that it intended the Directed Order allocation to reward members and member organizations that are quoting at the NBBO when a Directed Order is received. The Exchange states that, at this time, the Exchange is not able to systematically enforce the requirement in Phlx Rule 1080(l)(ii) that a Directed Specialist, SQT, or RSQT be quoting at the NBBO at the time a Directed Complex Order is received to receive a Directed Complex Order allocation pursuant to Rule 1014(g)(viii). The Exchange believes that it is necessary to have the ability to systematically enforce the requirements of Phlx Rule 1080(l)(ii) with respect to Directed Complex Orders to assure that the Exchange's Directed Complex Order rules operate as intended. Accordingly, the Exchange requests a waiver of the 30-day operative delay to allow the Exchange to discontinue the participation allocation for Directed Complex Orders prior to December 1, 2016.<sup>17</sup> The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because the proposed rule change will allow the Exchange to discontinue the participation allocation for Directed Complex Orders until the Exchange is able to systematically enforce the requirements of Phlx Rule 1080(l)(ii) with respect to Directed

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<sup>16</sup> The Exchange will provide prior notice of the change in the form of an Options Trader Alert.

<sup>17</sup> As noted above, the Exchange may seek to offer a participation allocation for Directed Complex Orders after the Exchange has the ability to systematically enforce the requirements of Phlx Rule 1080(l)(ii) with respect to Directed Complex Orders.



Complex Orders.<sup>18</sup> Accordingly, the Commission designates the proposed rule change to be operative upon filing.<sup>19</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 action is necessary or appropriate in the public interest, for the protection of investors, or 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-2016-116 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.

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<sup>18</sup> The Commission also notes that the Exchange stated that if it intends to offer a participation allocation for Directed Complex Orders in the future it will file a proposed rule change with the Commission.

<sup>19</sup> For purposes only of waiving the 30-day operative delay, the Commission has also considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

All submissions should refer to File Number SR-Phlx-2016-116. 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; 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-2016-116 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>20</sup>

Robert W. Errett  
Deputy Secretary

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<sup>20</sup> 17 CFR 200.30-3(a)(12).