

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-80074; File No. SR-Phlx-2016-105)

February 21, 2017

Self-Regulatory Organizations; NASDAQ PHLX LLC; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of Proposed Rule Change, as modified by Amendment No. 1, to Amend Rules 501, 507, 508, 510, and 511 of the Exchange

I. Introduction

On December 21, 2016, NASDAQ PHLX LLC (“Phlx” or the “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend Rule 501 (Specialist Appointment), Rule 507 (Application for Approval as an SQT, RSQT, or RSQTO and Assignment in Options), Rule 508 (Transfer Application), Rule 510 (SQT and RSQT Performance Evaluation), and Rule 511 (Specialist Allocation and Performance Evaluation).³ The proposed rule change was published for comment in the Federal Register on January 9, 2017.⁴ On February 15, 2017, the Exchange filed Amendment No. 1 to the proposed rule change, which superseded the original filing in its entirety.⁵ The Commission received no

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See infra notes 6-8 for definitions of Specialist, SQT, RSQT, and RSQTO.

⁴ See Securities Exchange Act Release No. 79724 (January 3, 2017), 82 FR 2418 (“Notice”).

⁵ In Amendment No. 1, the Exchange: (1) specified that members of the panel that may be appointed by the Board of Directors to consider certain appeals may not have been involved at all in the decision appealed from (rather than not being materially involved) and must otherwise have no conflict of interest; and (2) clarified that when selecting members for such panel, the Board of Directors shall choose individuals whose background, experience, and training qualify them to consider and make determinations regarding the subject matter to be presented to the panel (rather than considering these factors to the extent practicable). To promote transparency of its proposed amendment, when Phlx filed Amendment No. 1 with the Commission, it also submitted Amendment No. 1 as a comment letter to the file, which the Commission posted on its website and

comments on the proposed rule change. The Commission is publishing this notice to solicit comment on Amendment No. 1 to the proposed rule change from interested persons, and is approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

II. Description of the Proposed Rule Change, as Modified by Amendment No. 1

The Exchange proposes to amend certain of its Series 500 Rules concerning the treatment of Specialists,⁶ SQTs,⁷ and RSQTs.⁸

A. Back-up Specialist Unit

The Exchange proposes to amend Rule 501 to remove the concept of a back-up specialist unit.⁹ Currently, an initial application to become a specialist unit must include, among other things, information about the proposed specialist unit's back-up arrangements, to include a back-

placed in the public comment file for SR-Phlx-2016-105 (available at <https://www.sec.gov/comments/sr-phlx-2016-105/phlx2016105-1589879-132169.pdf>). The Exchange also posted a copy of its Amendment No. 1 on its website (http://nasdaqphlx.cchwallstreet.com/NASDAQPHLX/pdf/phlx-filings/2016/SR-Phlx-2016-105_Amendment_1.pdf) when it filed Amendment No. 1 with the Commission.

⁶ A "Specialist" is an Exchange member who is registered as an options specialist pursuant to Rule 1020(a). A "Remote Specialist" is an options specialist that does not have a physical presence on an Exchange floor. See Rule 1020(a)(i) and (ii).

⁷ An "ROT" is 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 Rule 1014(b)(i). A "Streaming Quote Trader" or "SQT" is an ROT who has received permission from the Exchange to generate and submit option quotations electronically in options to which such SQT is assigned. See Rule 1014(b)(ii)(A).

⁸ A "Remote Streaming Quote Trader" or "RSQT" is an ROT that is a member affiliated with a "Remote Streaming Quote Trader Organization" or "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. See Rule 1014(b)(ii)(B). See also Rule 507(a).

⁹ Specifically, the Exchange proposes to remove references to back-up specialist units in Rule 501(b) and (f)(ii), and delete a provision in Rule 501, Commentary .01, concerning treatment under Rule 748(b), which relates to designation of supervisors by member organizations of individuals employed by the back-up specialist unit. See proposed Rule 501(b), (f)(ii), and Commentary .01.

up specialist unit and a substitute specialist unit. The back-up specialist unit provides staffing when necessary and is not associated with the specialist unit. The substitute specialist unit, which may be the same as the back-up specialist unit, serves as a substitute in the event that the specialist unit is unable to perform the duties of a Specialist.¹⁰

The Exchange believes that the function of providing back-up staffing when needed from one specialist unit on the floor to another is no longer feasible because multiple specialist units are no longer present on the floor.¹¹ The Exchange notes that the other initial application requirements in Rule 501 will remain unchanged.¹²

B. Approval of SQT and RSQT Applications

The Exchange proposes to amend Rule 507(a) to replace the role of the Board of Directors (“Board”) with Exchange staff with respect to deferring or limiting the approval of SQT and RSQT applications.¹³ Currently, the Board may defer, for a period to be determined in the Board’s discretion, approval of qualifying applications for SQT or RSQT status pending any action required to address the issue of concern to the Board based on system constraints, capacity restrictions, or other factors relevant to the maintenance of a fair and orderly market. Further, the Board may not defer a determination of the approval of the application of any SQT or RSQT applicant, or place any limitations on access to the Exchange’s electronic quoting and trading system on any SQT or RSQT applicant, unless the basis for such limitations or deferral have been objectively determined by the Board, subject to Commission approval or effectiveness

¹⁰ See Rule 501(b).

¹¹ See Notice, *supra*, note 4, at 2419 n.10.

¹² See id. at 2419 (citing Rule 501(a) and (b)).

¹³ See proposed Rule 507(a) (replacing references to the “Board” with “Exchange”).

pursuant to a rule change filing under Section 19(b) of the Act.¹⁴ The Exchange proposes to have Exchange staff perform this role of deferring or limiting approval of SQT and RSQT applications, subject to the rule's existing restrictions.¹⁵ The Exchange believes that this change will help with the administration and application of Rule 507.¹⁶

C. Good Standing Requirement for Specialists, SQTs, and RSQTs

The Exchange proposes to revise Rule 510 to implement a good standing requirement for Specialists, SQTs, and RSQTs.¹⁷ Currently, Rule 510 requires the Exchange to periodically conduct performance evaluations of member organizations that have SQTs and RSQTs to determine whether they have fulfilled specified performance standards. Rule 510 includes procedures the Exchange will follow if an SQT or RSQT fails to meet minimum performance standards and appeal rights.¹⁸ Similarly, Rule 511 requires the Exchange to at least annually, and as frequently as monthly, conduct evaluations of Specialists to determine whether they have fulfilled specified performance standards. Rule 511 contains procedures for Specialists that fail to meet performance standards, including appeal rights. Rule 511 also contains provisions concerning the allocation of new options classes and transfers or reallocations of existing options classes, which can be based on the results of performance evaluations, including evaluations conducted upon special circumstances.¹⁹ The Exchange proposes to delete existing Rules 510 and 511 in their entirety and replace them with a new Rule 510 that will apply to Specialists,

¹⁴ See Rule 507(a).

¹⁵ The Exchange explains that its Membership department, which currently reviews membership applications for equities and options members of the Exchange, would review applications for SQTs and RSQTs. See Notice, supra note 4, at 2419 n.12.

¹⁶ See id. at 2419.

¹⁷ See proposed Rule 510.

¹⁸ See Rule 510.

¹⁹ See Rule 511.

SQTs, and RSQTs and include good standing requirements and procedures if the participants fail to meet such requirements, including appeal rights.²⁰

Under the proposal, to remain in good standing as a Specialist, SQT, or RSQT, the Specialist, SQT, or RSQT would be required to:

- continue to meet the requirements established in Commission Rule 15c3-1(a)(6)(i),²¹ and the requirements set forth in the Series 500 Rules in the Rules of the Exchange;
- continue to satisfy the Specialist, SQT, or RSQT qualification and market making requirements specified by the Exchange, as amended from time to time;
- comply with the Rules of the Exchange and the Options Rules as well as the rules of The Options Clearing Corporation and the rules of the Federal Reserve Board; and
- pay on a timely basis such member, transaction, and other fees as the Exchange shall prescribe.²²

The Exchange believes that in light of the proposed continuous and extensive good standing requirements and other rule requirements, the periodic evaluations currently applicable to Specialists, SQTs, and RSQTs are no longer needed.²³ The Exchange represents that it will monitor compliance with good standing requirements across the Exchange.²⁴

²⁰ See proposed Rule 510. Consistent with this change, the proposal would conform the title of this rule. See id. Additionally, the proposal would reserve Rule 511. See proposed Rule 511.

²¹ See 240 CFR 15c3-1(a)(6)(i) (net capital requirements for brokers or dealers).

²² See proposed Rule 510(a).

²³ See Notice, supra note 4, at 2420 n.22.

²⁴ See id. at 2422 n.36. The Exchange explains that, for example, membership, listing, and finance groups monitor applications, allocations, and compliance with fee requirements, and the surveillance group will continue to monitor compliance with Exchange rules and pursue disciplinary actions for rule violations, as necessary (e.g., for failure to comply with continuous two-sided quoting requirements). See id.

The proposal would also provide that the good standing of a Specialist, SQT, or RSQT may be suspended, terminated, or otherwise withdrawn if any of the conditions for approval cease to be maintained or the Specialist, SQT, or RSQT violates any of its agreements with the Exchange or any of the provisions of the Rules of the Exchange or of the Options Rules. The Exchange would be required to provide written notice to a Specialist, SQT, or RSQT of a contemplated action regarding good standing. Additionally, a Specialist, SQT, or RSQT would be able to request, and the Exchange might hold, an informal meeting to discuss the alleged failure to remain in good standing and to explore possible appropriate remedies. Written notice of the date and time of the meeting would need to be given to the Specialist, SQT, or RSQT and no verbatim record would be kept. If the Exchange were to believe that there were no mitigating circumstances that would demonstrate substantial improvement of or reasonable justification for the failure to meet good standing requirements, the Exchange could take appropriate action. Nothing in the informal meeting process would limit the Exchange from bringing disciplinary actions for violations of these rules.²⁵ Finally, the Exchange notes that it will provide appeal rights from decisions concerning good standing, as described further below.²⁶

With respect to Rule 511, the Exchange believes it is proper to delete this rule because Specialists will be covered by Rule 510, with respect to good standing requirements, and will also be covered by other rules of the Exchange.²⁷ The Exchange explains that it adopted Rule 511, with a process for Specialist evaluations and allocations, several decades ago for the

²⁵ See proposed Rule 510(b). The Exchange explains that, for example, it could pursue a disciplinary process against a member that commits an egregious market making violation evidenced by a pattern of repeated failure to make a two-sided market in assigned options. See Notice, *supra* note 4, at 2421 n.32.

²⁶ See Notice, *supra* note 4, at 2421. See also *infra* Section II.D.

²⁷ See Notice, *supra* note 4, at 2422.

purpose of dealing with an extensive on-floor open outcry Specialist system that had multiple competing specialist units. The Exchange adds that the current system is mainly electronic and off-floor, and the remaining hybrid options floor does not have numerous competing Specialists.²⁸

D. Appeal Rights

The Exchange proposes to amend Rule 507(e) to change the composition of the deliberative body that will hear an appeal to the Board, upon request by a member or member organization, from a decision of the Exchange pursuant to Rule 507, which concerns SQT, RSQT, and RSQTO applications and options assignments.²⁹ Currently, an appeal from a decision pursuant to Rule 507 is heard by a special committee of the Board composed of three directors, at least one of whom must be independent.³⁰ Under the proposal, such appeal would be heard by the full Board or a panel appointed by the Board composed of three members not involved in the Exchange decision appealed from and who otherwise have no conflict of interest (“Board Panel”). If the Board appointed a Board Panel, the Board would select three individuals to serve on the Board Panel, choosing individuals whose background, experience, and training qualify them to consider and make determinations regarding the subject matter to be presented to the Board Panel. Further, the Board Panel would consist of two members of the Exchange, or general partners or officers of member organizations, and one other person who would qualify as

²⁸ See id. The Exchange states that there is currently one specialist unit operating on the options floor. See id. The Exchange believes that even if additional Specialists begin to conduct business on the options floor, Rule 511 was designed for a very different, competitive floor environment and will not be needed. See id. at 2422 n.38.

²⁹ See proposed Rule 507(e).

³⁰ See Rule 507(e).

a public member as defined in Article I of the Exchange’s By-Laws,³¹ whom the Board considers to be qualified.³²

The Exchange proposes to add Rule 510(c) to adopt parallel appeal rights for an appeal by a Specialist, SQT, or RSQT to the Board, upon request by a member or member organization interested therein, from a decision of the Exchange pursuant to Rule 510, which concerns good standing requirements.³³ Currently, Rule 511(f) contains appeal procedures for decisions concerning performance evaluations of Specialists, which procedures are equivalent to those found in Rule 507(e), while Rule 510(d) provides a right of direct appeal to the Board from a decision concerning performance evaluations of SQTs and RSQTs.³⁴

Under the proposal, a Specialist, SQT, or RSQT could request an appeal by filing a written notice of appeal with the Secretary of the Exchange within ten days after the decision being appealed has been rendered. The appeal would be heard by the Board or a Board Panel, which would be subject to the same composition requirements discussed above.³⁵ The person requesting review would be permitted to submit a written statement to and appear before the

³¹ Article I of the Exchange’s By-Laws defines “public member” as “a member of any committee appointed by the Board of Directors who has no material business relationship with a broker or dealer, the Exchange, or its affiliates.” See By-Laws, Article I(hh). The Exchange notes that while at least one member of the current special committee must be an independent director, the Board Panel would require the inclusion of one person who would qualify as a public member, which requirement also provides some measure of independence. See Notice, supra note 4, at 2419 n.14.

³² See proposed Rule 507(e). The proposal would make conforming changes to the remainder of Rule 507(e), which addresses process requirements for the appeal, to replace references to “special committee” with “Board or Board Panel.” The existing provision that there is no appeal to the Board from a decision of the special committee would be revised to apply to a decision of the Board Panel. See id.

³³ See proposed Rule 510(c).

³⁴ See Rules 507(e), 511(f).

³⁵ See supra notes 31-32 and accompanying text.

Board or Board Panel. The Secretary of the Exchange would certify the record of the proceeding, if any, and the written decision, and would submit the documents to the Board or Board Panel. The Board or Board Panel's review of the action would be based solely on the record, the written decision, and any statement submitted by the person requesting the review. The Board or Board Panel would prepare and deliver to such person a written decision and reasons therefore. If the Board or Board Panel affirmed the action, the action would become effective ten days from the date of that decision. There would be no appeal to the Board from any decision of the Board Panel.³⁶

The Exchange believes that the proposed appeal rights are appropriate because they would cover any decision of the Exchange regarding Rule 510 and any appeal would follow the proposed informal meeting process. The Exchange adds that the proposed process would serve as a secondary appeal to individuals not involved in making the initial decision and stated that it seeks to provide its members due process when seeking an appeal.³⁷

E. Additional and Conforming Changes

The Exchange proposes to amend Rule 508, concerning transfer applications. First, the proposal would remove a reference to leasing.³⁸ The Exchange explains that leasing is no longer practiced on the Exchange and it therefore is deleting this obsolete term.³⁹ Second, the proposal would remove a reference to Rule 511.⁴⁰ The Exchange explains that Rule 511 would be deleted

³⁶ See proposed Rule 510(c).

³⁷ See Notice, supra note 4, at 2421 n.33.

³⁸ See proposed Rule 508.

³⁹ See Notice, supra note 4, at 2420. The Exchange deleted another reference to leasing in its rules on the same basis. See Securities Exchange Act Release No. 77121 (February 11, 2016), 81 FR 8308 (February 18, 2016) (SR-Phlx-2016-22).

⁴⁰ See proposed Rule 508.

by the proposal⁴¹ and Rule 508 will continue to indicate that failure to provide the exchange with prior notice of a transfer, in accordance with Rule 508, or failure to obtain Exchange approval of a transfer, permits the Exchange to recover the allocated securities and allocate them pursuant to Rule 506.⁴²

Finally, the Exchange proposes to amend Rule 507(b)(iii)(C) to reflect the proposed changes to Rule 510 that would implement a good standing requirement.⁴³ Currently, this provision provides that, when making a decision concerning an application for assignment in an option when there are more applicants for assignment in a particular option than there are positions available, the Exchange shall consider the applicant's prior performance as a Specialist, SQT, or RSQT based on evaluations conducted pursuant to Rule 510.⁴⁴ The Exchange explains that in light of the proposed good standing requirement, as discussed above,⁴⁵ it has proposed to update this provision to state that the Exchange can consider the applicant's prior performance as a Specialist, SQT, or RSQT based on good standing pursuant to Rule 510.⁴⁶

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁴⁷ In particular, the Commission finds that the proposed rule change is

⁴¹ See supra notes 19-20 and accompanying text.

⁴² See Notice, supra note 4, at 2420 & n.21.

⁴³ See proposed Rule 507(b)(iii)(C).

⁴⁴ See Rule 507(b)(iii)(C). Other factors for consideration include the financial and technical resources available to the applicant and the applicant's experience and expertise in market making or options trading. See Rule 507(b)(iii)(A), (B).

⁴⁵ See supra notes 17-20 and 22 and accompanying text.

⁴⁶ See Notice, supra note 4, at 2419.

⁴⁷ In approving this proposed rule change, the Commission has considered the proposed

consistent with Section 6(b)(5) of the Act,⁴⁸ which requires, among other things, that the rules of a national securities exchange be designed 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.

The Exchange represents that, because of the development of liquidity-enhancing electronic market makers on the Exchange that make markets in the same options issues as Specialists and the diminution of the role that the Specialist plays in managing the order book on the Exchange, Specialists no longer need to have both a back-up specialist unit and a substitute specialist unit.⁴⁹ The Commission notes that a substitute specialist unit will still be available if the specialist unit is unable to perform the duties of a Specialist and that the presence of SQTs and RSQTs, which have continuous quoting obligations, will serve as an additional source of liquidity for the Exchange if a specialist unit on the floor experiences a staffing problem.⁵⁰

The Commission notes that the proposal to require Exchange staff, rather than the Board, to make determinations to defer or limit an application of an SQT or RSQT is designed to facilitate the administration and application of Rule 507. The Commission also notes that any deferral or limitation would be objectively determined by the Exchange. The proposal would also require the Exchange to provide written notification to any SQT or RSQT applicant whose application is the subject of such limitation or deferral, describing the objective basis for such

rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁴⁸ 15 U.S.C. 78f(b)(5).

⁴⁹ See Notice, supra note 4, at 2418-19.

⁵⁰ The Commission notes that currently Remote Specialists are not required to meet the back-up specialist unit requirement. See Rule 501(f)(ii). See also Securities Exchange Act Release No. 63717 (January 14, 2011), 76 FR 4141 (January 24, 2011) (SR-Phlx-2010-145).

limitation or deferral. Further, an SQT or RSQT applicant would have the right to an appeal to the Board or a Board Panel from any such decision by Exchange staff pursuant to Rule 507(e).⁵¹

The Commission notes that the proposed good standing requirements are designed to evaluate compliance by Specialists, SQTs, and RSQTs with Exchange rules and the rules of the Commission and other regulators and are consistent with the rules of other options exchanges.⁵² The Exchange represents that its staff, including its surveillance group, will monitor compliance with such rules.⁵³ The Commission notes that while Specialist allocation procedures are not included within proposed Rule 510, Specialists will continue to be subject to numerous existing rules, some of which address allocation of options.⁵⁴

The Commission believes that the Exchange's use of the Board or a Board Panel to hear appeals of Exchange decisions pursuant to Rules 507 and 510, as opposed to a special committee of the Board, would retain an opportunity for the SQT, RSQT, or Specialist to be heard on the matter before the Exchange takes remedial action. The Commission notes the requirements that members of the Board Panel will not be involved in the Exchange decision appealed from, have no conflicts of interest, and be considered by the Board to be qualified, and that one member will be a person who would qualify as a public member as defined in Article I of the By-Laws. The revised appeal procedures for decisions pursuant to Rule 510 concerning SQTs and RSQTs mirror procedures already in place in other contexts.

Finally, the Commission believes that the proposal's minor, conforming revisions to

⁵¹ See Notice, supra note 4, at 2419. See also supra Section II.D.

⁵² See BX Options Rules, Chapter VII, Section 4; Nasdaq Options Rules, Chapter VII, Section 4.

⁵³ See supra note 24 and accompanying text.

⁵⁴ See proposed Rule 508; Rules 506, 513. See also Rules 501, 1014, 1022.

Rules 507 and 508 are consistent with the Act.

IV. Solicitation of Comments on Amendment No. 1

Interested persons are invited to submit written data, views, and arguments concerning whether Amendment No. 1 to 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. Please include File Number SR-Phlx-2016-105 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-2016-105. 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 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 available publicly. All submissions should refer to File Number SR-Phlx-2016-105, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 1

The Commission finds good cause to approve the proposed rule change, as modified by Amendment No. 1, prior to the thirtieth day after the date of publication of the notice of Amendment No. 1 in the Federal Register. As described above, in Amendment No. 1, Phlx updated its proposal to reflect: (1) that members of the Board Panel may not have been involved at all in the decision appealed from and must otherwise have no conflict of interest; and (2) that the Board shall choose individuals whose background, experience, and training qualify them to consider and make determinations regarding the subject matter to be presented to the panel. The Commission believes that Amendment No. 1 clarifies the criteria for ensuring the independence of the Board Panel that could hear an appeal pursuant to Rules 507 and 510. Accordingly, for the reasons noted above, the Commission finds good cause for approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis, pursuant to Section 19(b)(2) of the Act.⁵⁵

⁵⁵ 15 U.S.C. 78s(b)(2).

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁵⁶ that the proposed rule change (SR-Phlx-2016-105), as modified by Amendment No. 1 thereto, be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁵⁷

Eduardo A. Aleman
Assistant Secretary

⁵⁶ Id.

⁵⁷ 17 CFR 200.30-3(a)(12).