

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-81409; File No. SR-Phlx-2017-67)

August 16, 2017

Self-Regulatory Organizations; NASDAQ PHLX LLC; Notice of Filing of Proposed Rule Change Related to the Floor Requirements

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 August 3, 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 Commentary .01 of Rule 1014, Obligations and Restrictions Applicable to Specialists and Registered Options Traders, to change quarterly trading requirements applicable to Registered Options Traders (“ROTs”), as described below.<sup>3</sup>

The text of the proposed rule change is set forth below. Proposed new language is italicized; deletions are bracketed.

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**Rule 1014 Obligations and Restrictions Applicable to Specialists and Registered Options Traders**

(a) – (g) No 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> A Registered Options Trader or 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 Exchange Rule 1014(b)(i).

## Commentary

**.01** An ROT electing to engage in Exchange options transactions is designated as a specialist on the Exchange for all purposes under the Securities Exchange Act of 1934 and the rules and regulations thereunder with respect to options transactions initiated and effected by him on the floor in his capacity as an ROT. For purposes of this commentary, the term “transactions initiated and effected on the floor” shall not include transactions initiated by an ROT off the floor, but which are considered “on-floor” pursuant to Commentaries .07 and .08 of Rule 1014. Similarly, an RSQT electing to engage in Exchange options transactions is designated as a specialist on the Exchange for all purposes under the Securities Exchange Act of 1934 and the rules and regulations thereunder with respect to options transactions initiated and effected by him in his capacity as an ROT.

[An ROT (other than an RSQT or a Remote Specialist)]A non-SQT ROT is required to trade either (a) 1,000 contracts and 300 transactions, or (b) 10,000 contracts and 100 transactions, on the Exchange each quarter. Transactions executed in the trading crowd where the contra-side is an ROT are not included.

In addition, in order for an ROT (other than an RSQT or a Remote Specialist) to receive specialist margin treatment for off-floor orders in any calendar quarter, the ROT must execute the greater of 1,000 contracts or 80% of his total contracts that quarter in person (not through the use of orders, except that non-streaming ROTs can use orders entered in person) and 75% of his total contracts that quarter in assigned options. Transactions executed in the trading crowd where the contra-side is an ROT are not included.

The off-floor orders for which an ROT receives specialist margin treatment shall be subject to the obligations of Rule 1014(a) and, in general, be effected for the purpose of hedging, reducing risk of, or rebalancing positions of the ROT. An ROT is responsible for evidencing compliance with these provisions. The Exchange may exempt one or more classes of options from this calculation.

**.02 - .19** No change.

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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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of the proposed rule change is to add flexibility to one of the Exchange's quarterly trading requirements to encourage liquidity-providing activity by market makers on the Exchange's trading floor. Phlx imposed this trading requirement initially to require market makers to ensure available liquidity on the trading floor. Liquidity provided by market makers is a key ingredient to ensuring a competitive trading floor. Market maker liquidity benefits all market participants by providing more trading opportunities. The Exchange's proposal is intended to ensure that market makers on the trading floor are ready and able to participate to provide a reasonable pool of liquidity on the floor trading. The Exchange also notes that other

options exchanges with physical trading floors do not have a minimum trading requirement similar to Phlx.

The general term “market makers” on the Exchange includes Specialists<sup>4</sup> and ROTs. ROTs can be either Streaming Quote Traders<sup>5</sup> (“SQTs”), Remote SQTs<sup>6</sup> (“RSQTs”) or non-SQT ROTs.<sup>7</sup> Today, quarterly trading requirements apply to two types of ROTs: SQTs and non-SQT ROTs. Specialists and RSQTs are subject to different requirements. By definition, non-SQT ROTs do not “stream” quotes, meaning send quotes electronically to the Exchange; instead, pursuant to Commentary .18 of Rule 1014, they submit limit orders electronically and respond to Floor Brokers verbally.

Specifically, the Exchange is proposing to amend a quarterly trading requirement set forth in Commentary .01.<sup>8</sup> Phlx Rule 1014 at Commentary .01 currently requires a ROT (other than an

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<sup>4</sup> A Specialist is an Exchange member who is registered as an options specialist pursuant to Rule 501(a). An options specialist includes a Remote Specialist which is defined as an options specialist in one or more classes that does not have a physical presence on an Exchange floor and is approved by the Exchange pursuant to Rule 501.

<sup>5</sup> An 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. 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 Rule 1014(b)(ii)(A).

<sup>6</sup> An RSQT is an ROT that is a member affiliated with and 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. A qualified RSQT may function as a Remote Specialist upon Exchange approval. See Rule 1014(b)(ii)(B).

<sup>7</sup> A non-SQT ROT is an ROT who is neither an SQT nor an RSQT. See Rule 1014(b)(ii)(C).

<sup>8</sup> In addition to the trading requirement being amended herein, the “in assigned” quarterly trading requirement in Commentary .03 requires that, except for unusual circumstances, at least 50% of the trading activity in any quarter (measured in terms of contract volume) of an ROT (other than an RSQT) shall ordinarily be in classes of options to which he is assigned. Temporarily undertaking the obligations of paragraph (c) at the request of a

RSQT or Remote Specialist) to trade 1,000 contracts and 300 transactions on the Exchange each quarter (excluding transactions executed in the trading crowd where the contra-side is an ROT).

This proposal seeks to amend this quarterly requirement of Commentary .01 in two ways: (1) by limiting the trading requirement to non-SQT ROTs; and (2) by adding a new test as an alternative. The Exchange proposes to amend Commentary .01 to require a non-SQT ROT (other than an RSQT or a Remote Specialist) to trade either (a) 1,000 contracts and 300 transactions (the “1000/300 Alternative,” which is the current requirement) or (b) 10,000 contracts and 100 transactions (the “New Alternative”), on the Exchange each quarter.

With respect to limiting the requirement to non-SQT ROTs, the Exchange notes that today, SQTs and RSQTs are obligated to continuous quoting requirements when trading electronically in their assigned options series.<sup>9</sup> Non-SQT ROTs are not subject to similar continuous quoting requirements today on the trading floor. If a non-SQT ROT trades electronically, that market maker would be required to continuously quote in his or her assigned option pursuant to the requirement in Rule 1014(b)(ii)(D), whereas if that market maker was on

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member of the Exchange in non-assigned classes of options is not deemed trading in non-assigned option contracts. Furthermore, Commentary .13 further provides that, within each quarter, an ROT must execute in person, and not through the use of orders, a specified number of contracts, such number to be determined from time to time by the Exchange. Options Floor Procedure Advice (“Advice”) B-3, Trading Requirements, establishes a quarterly requirement to trade the greater of 1,000 contracts or 50% of contract volume in person; pursuant to the Exchange’s minor rule violation and enforcement plan, it establishes a fine schedule for violations thereof, as well as for violations of the quarterly trading requirement in assigned options contained in Commentary .03. Commentary .01 also requires that in order for an ROT (other than an RSQT or a Remote Specialist) to receive specialist margin treatment for off-floor orders in any calendar quarter, the ROT must execute the greater of 1,000 contracts or 80% of his total contracts that quarter in person (not through the use of orders, except that non-streaming ROTs can use orders entered in person) and 75% of his total contracts that quarter in assigned options (excluding transactions executed in the trading crowd where the contra-side is an ROT). None of these trading requirements are changing.

<sup>9</sup> See Rule 1014(b)(ii)(D).

the trading floor in the capacity of a non-SQT ROT, the market maker would be required to separately meet the requirements of Phlx Rule 1014 at Commentary .01. With this proposal, the Exchange is proposing a separate requirement for market makers that conduct business on the trading floor as compared to market makers who transact business electronically on the Exchange.

With respect to adding the alternative, similar to the requirement today, transactions executed in the trading crowd where the contra-side is an ROT would not be included.<sup>10</sup> Similar to the current 1000/300 Alternative, the New Alternative is a pure trading requirement, not limited, like the other trading requirements, to assigned options<sup>11</sup> and in person trading.<sup>12</sup> Accordingly, the New Alternative requirement can be fulfilled with trades and contracts that are not in assigned options and not executed in person, although, of course, the existing trading requirements respecting “in assigned” options and “in person” trading must still be met. Also, limit orders can continue to be counted toward either minimum trading requirement. The Exchange recognizes that floor trading is a competitive space and that Phlx is the only floor trading venue requiring its market makers on the trading floor to transact a minimum amount of

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<sup>10</sup> The Exchange already excludes from the contracts and transactions required by the current 1000/300 Alternative, in each quarter, any transactions executed in the trading crowd where the contra-side is an ROT in order to focus market making efforts on providing the sort of liquidity that will attract customers (including broker-dealers and professionals) to the Exchange, and is extending this exclusion to the New Alternative for the same reason. As with the 1000/300 Alternative currently in effect, ROTs will continue to be able to participate in crowd trades, and those crowd trades will count towards the new trading requirement, unless the contra-side is another ROT. ROT-to-ROT trades in the crowd are certainly permissible on the Exchange, but the Exchange seeks to better target liquidity and attract order flow by designing the trading requirement to exclude them.

<sup>11</sup> See Rule 1014.03.

<sup>12</sup> See Rule 1014.01.

contracts. The Exchange is not seeking to burden these market participants by limiting the type of qualifying transactions to meet the requirement.

By way of background, the Exchange adopted the 1000/300 Alternative, the existing requirement, in 2011.<sup>13</sup> At that time the Exchange believed this quarterly requirement would be a reasonable and fair measure to ensure ROTs were actively providing liquidity. Since that time the Exchange has observed that larger order sizes continue to seek liquidity on the trading floor, drawing regular responses from non-SQT ROTs whose business is centered around larger sized transactions, but not always resulting in transactions for these larger non-SQT ROT firms providing liquidity.

The Exchange has observed that certain non-SQT ROTs, who trade larger sized orders and who only trade a handful of underlying stocks are making markets on a daily basis but are having less opportunity because larger orders are often placed into the Qualified Contingent Cross (QCC) mechanism.<sup>14</sup> Consequently there are fewer opportunities for some non-SQT ROTs to make certain trades. The Exchange notes that ROTs may not enter responses to QCC Orders which are paired orders entered into the QCC Mechanism and are not exposed. While the introduction of QCC accounts for a portion of the types of qualifying orders that a non-SQT ROT can transact to fulfill the floor requirement, lower volumes on the trading floor has also contributed to the desire among market participants to fulfill the trading requirement in an alternative fashion.

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<sup>13</sup> See Securities Exchange Act Release No. 65644 (October 27, 2011), 76 FR 67786 (November 2, 2011) (SR-Phlx-2011-123).

<sup>14</sup> See Securities Exchange Act Release No. 64249 (April 7, 2011), 76 FR 20773 (April 13, 2011) (SR-Phlx-2011-47) (a rule change to establish a QCC Order to facilitate the execution of stock/option Qualified Contingent Trades (“QCTs”) that satisfy the requirements of the trade through exemption in connection with Rule 611(d) of the Regulation NMS).

The Exchange is now proposing to address this issue by modifying the 1000/300 Alternative trading requirement to include the New Alternative as an additional metric, one that could be satisfied by fewer transactions but more traded contracts, such that the overall trading requirement originally contemplated by the 1000/300 Alternative is not diluted. After discussing this issue with the larger non-SQT ROTs who are very active on a daily basis, the Exchange determined that 100 transactions per quarter was a reasonable number to measure whether a non-SQT ROT is providing liquidity to the market. The Exchange concluded that a reduced number of 100 transactions per quarter would permit non-SQT ROTs to make their trading decisions without undue influence of quoting [sic] obligations alone, and instead choose whether to participate in trades based on factors independent of the actual quoting [sic] obligation.

The Exchange believes that the value of a non-SQT ROT is not limited to only whether they actually execute transactions, but as important is that they are actively quoting markets and providing pricing information. Since 100 transactions is only 33% of the current requirement, the Exchange determined to increase the total executed contracts number by 900 percent to 10,000 contracts, to ensure that the Exchange did not diminish the trading requirement when viewed from an overall perspective. The Exchange believes this alternative requirement is a good measure that improves the analysis of whether the larger non-SQT ROT's are participating in an expected manner, and providing liquidity to the market.

The Exchange notes that in order to meet the floor trading requirements a non-SQT ROT may either continue to comply with the current requirement or may voluntarily comply with the New Alternative. The existing requirement is based on the ability to trade 1,000 contracts and 300 transactions on the Exchange each quarter, more contracts but of a smaller size. The New Alternative permits compliance with the quoting [sic] rules by transacting fewer transactions



(100 transactions) but larger sized volume (10,000 contracts). The two options to comply with the floor trading rule do not vary in terms of benefits or obligations.

The Exchange believes the combined test of “10,000 contracts” and “100 transactions” would be a fair measure of liquidity as an alternative to complement the current requirement, and is a fair and balanced way to measure whether a non-SQT ROT is providing liquidity to the marketplace. This proposed new measure will be a fairer measure for market makers on the trading floor in that it considers another perspective of liquidity - specifically, the offering of deep liquid markets which result in fewer executions, but of greater size.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>15</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>16</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 adopting a new alternative trading requirement which will narrow the requirement for ROTs, who have other quoting obligations, while also providing flexibility to non-SQT ROTs to encourage market making which should enhance liquidity on the Exchange. It would be unjust and inequitable to continue to impose the 1000/300 Alternative trading requirement without also offering non-SQT ROTs this New Alternative given the recent availability of QCC to handle large orders that previously may have been executed by certain non-SQT ROTs in satisfaction of the 1000/300 Alternative test along with lower volumes on the trading floor.

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

<sup>16</sup> 15 U.S.C. 78f(b)(5).

The Exchange believes that removing the requirement that SQTs and RSQTs [sic] are required to meet the trading requirement is consistent with just and equitable principles of trade because these market participants are subject to continuous quoting requirements today.<sup>17</sup> The Exchange intends to separate the two requirements. If a non-SQT ROT trades electronically, that market maker would be required to continuously quote in his or her assigned option pursuant to the requirement in Rule 1014(b)(ii)(D), whereas if that market maker was on the trading floor in the capacity of a non-SQT ROT, the market maker would be required to separately meet the requirements of Phlx Rule 1014 at Commentary .01. Non-SQT ROTs are not subject to continuous quoting requirements today and therefore the Exchange proposes to separately applying a standard consistent with their business model and exclude other ROTs from this floor-based requirement.

The proposal will remove impediments to and perfect the mechanism of a free and open market and a national market system by providing a new alternative to an existing requirement that today non-SQT ROTs have difficulty meeting given the current trading environment, thus enabling them to continue making markets to the benefit of investors by requiring ample liquidity. Investors and the public interest are protected by the proposal in that it should help preserve the number of non-SQT ROTs making markets and providing liquidity to the benefit of users of the Exchange's market.

It is important to note that a non-SQT ROT cannot control the size and frequency of crowd trades, even less so crowd trades where the contra-side is not an ROT. The Exchange represents that the only other way to participate in trades other than through the use of orders is by quoting; while SQTs quote electronically by "streaming" quotations into the Exchange, non-

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<sup>17</sup> See Rule 1014(b)(ii)(D).

SQT ROTs may only quote verbally in response to floor brokers representing orders in the trading crowd. The Exchange believes that it has become difficult for such ROTs to comply with the trading requirements. The Exchange believes that this new trading requirement should increase the likelihood that an ROT is actively providing liquidity on Phlx. The Exchange believes that the proposed new trading requirement should enhance the market making functions for non-SQT ROTs and serve to maintain a fair and orderly market thereby promoting the protection of investors and the public interest.

The Exchange notes that non-SQT ROTs may meet the proposed requirement by entering limits orders, but the Exchange notes that the Exchange is not seeking to burden these market participants by limiting the type of qualifying transactions to meet the requirement. The Exchange recognizes that floor trading is a competitive space and that Phlx is the only floor trading venue requiring its market makers on the trading floor to transact a minimum amount of contracts. The Exchange is not proposing to remove the ability to enter limit orders to meet the New Alternative because it seeks to encourage market makers to transact business on Phlx.

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 respect to intra-market competition, limiting the trading requirement to non-SQT ROTs, the Exchange does not believe this imposes an undue burden on competition because SQTs and RSQTs are subject to continuous quoting requirements today,<sup>18</sup> while non-SQT ROTs are not subject to continuous quoting obligations.

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<sup>18</sup> See Rule 1014(b)(ii)(D).

Further, with respect to inter-market competition, the Exchange also notes that other options exchanges with physical trading floors do not have a minimum trading requirement similar to Phlx. The New Alternative trading requirement would be available to non-SQT ROTs without distinction, as an alternative to the existing 1000/300 Alternative trading requirement. The Exchange's proposal to permit non-SQT ROTs to comply with the trading requirement in one of two ways provides these market participants a means to compete in a space which has witnessed lower trading volumes. Also, the Exchange does not seek to disadvantage these market participants who compete with other trading floors who do not have trading requirements, as noted above, and also who do not have the automated compliance checks.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission shall: (a) by order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be 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-2017-67 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-2017-67. 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-2017-67, 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>19</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>19</sup> 17 CFR 200.30-3(a)(12).