

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-61426; File No. SR-Phlx-2010-05)

January 26, 2010

Self-Regulatory Organizations; NASDAQ OMX PHLX, Inc.; Notice of Filing of Proposed Rule Change Relating to Professional Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹, and Rule 19b-4² thereunder, notice is hereby given that on January 12, 2010, NASDAQ OMX PHLX, Inc. ("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 its priority rules to give certain non-broker-dealer orders the same priority as broker-dealer orders.

The text of the proposed rule change is available on the Exchange's Website at <http://nasdaqomxphlx.cchwallstreet.com/NASDAQOMXPHLX/Filings/>, at the principal office of the Exchange, and at the Commission's Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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 the proposed rule change is to adopt the new term "professional" for purposes of the Exchange's priority rules. Currently, pursuant to Rule 1014(g), a customer account is an account other than a controlled account; a controlled account is an account controlled by or under common control with a broker-dealer. Rule 1014(g) governs, among other things, the allocation of orders and, thus, the priority over and parity among orders and quotations.

Customer priority is one of the marketplace advantages provided to customer orders on the Exchange; customer priority means that customer orders are given execution priority over non-customer orders and quotations of specialists and Registered Options Traders ("ROTs") at the same price. Another marketplace advantage afforded to customer orders on the Exchange is that member organizations are generally not charged transaction fees for the execution of

customer orders. The purpose of these marketplace advantages is to attract retail order flow to the Exchange by leveling the playing field for retail investors over market professionals.³

With respect to these Phlx marketplace advantages, the Exchange does not believe that the current definition of customer account versus controlled account properly distinguishes between non-professional retail investors and certain professionals. According to the Exchange, providing marketplace advantages based upon whether the order is for the account of a participant that is a registered broker-dealer is no longer appropriate in today's marketplace, because some non-broker-dealer individuals and entities have access to information and technology that enables them to professionally trade listed options in the same manner as a broker or dealer in securities.⁴ These individual traders and entities (collectively, "professionals") have the same technological and informational advantages over retail investors as broker-dealers trading for their own account, which enables them to compete effectively with broker-dealer orders and market maker quotes for execution opportunities in the Phlx marketplace.⁵

³ Market professionals have access to sophisticated trading systems that contain functionality not available to retail customers, including things such as continuously updated pricing models based upon real-time streaming data, access to multiple markets simultaneously and order and risk management tools.

⁴ For example, some broker-dealers provided their professional customers with multi-screened trading stations equipped with trading technology that allows the trader to monitor and place orders on all six options exchanges simultaneously. These trading stations also provide compliance filters, order managements tools, the ability to place orders in the underlying securities, and market data feeds. See Securities Exchange Act Release Nos. 59287 (January 23, 2009), 74 FR 5964 (January 30, 2009)(SR-ISE-2006-26)(order approving International Securities Exchange ("ISE") proposal to introduce priority customer and professional orders) and 57254 (February 1, 2008), 73 FR 7345 (February 7, 2008) (SR-ISE-2006-26)(notice of ISE proposal to introduce priority customer and professional orders) at note 8.

⁵ Specialists and ROTs enter quotes based upon the theoretical value of the option, which moves with various factors in their pricing models, such as the value of the underlying security. Professional customers place and cancel orders in relation to an option's

Therefore, the Exchange does not believe it is consistent with fair competition for the professional account holders to continue to receive the same marketplace advantages as retail investors over broker-dealers trading on the Phlx. Moreover, because customer orders at the same price are executed in time priority, retail investors are prevented from benefitting fully from the priority advantage when professionals are afforded customer priority.

Accordingly, the Exchange is seeking to adopt a new term that will be used to more appropriately provide Phlx marketplace advantages to retail investors on the Phlx. Under the proposal, a “professional” will be defined in Rule 1000 as a person or entity that (i) is not a broker or dealer in securities, and (ii) places more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). Under the proposal, a professional account will be treated in the same manner as an off-floor broker-dealer (controlled account) for purposes of Phlx Rule 1014(g)(except with respect to all-or-none orders, which will be treated like customer orders), 1064(b), 1064.02, and 1080.08.

The proposal will not otherwise affect non-broker-dealer individuals or entities under Phlx rules, and all customer orders will continue to be treated equally for purposes of the linkage-related rules, including non-broker-dealer orders included in the definition of "professional" orders.⁶ The Exchange, which currently routes only eligible customer orders, would route eligible professional orders.

theoretical value in much the same manner as a specialists and ROTs. This is evidenced by the entry of limit orders that join the best bid or offer and by a very high rate of orders that are cancelled. In contrast, retail customers who enter orders as part of an investment strategy (such as covered write or directional trade) most frequently enter marketable orders or limit orders that they do not cancel and replace. See, e.g. Securities Exchange Act Release No. 57254 at note 9.

⁶ See Phlx Rule 1080(m), 1083, 1084, and 1086. These rules are not included by the proposed rule change in the list of rules, supra, for which the professional designation would apply.

In order to properly represent orders entered on the Exchange according to the new definition, member organizations will be required to indicate whether customer orders are “professional” orders.⁷ To comply with this requirement, member organizations will be required to review their customers’ activity on at least a quarterly basis to determine whether orders that are not for the account of a broker-dealer should be represented as customer orders or professional orders.⁸

The Exchange is also proposing to amend Rule 1063(e) and the corresponding Options Floor Procedure Advice (“Advice”) C-3, Options Floor Broker Management System, to require Floor Brokers to record the “professional” designator in the Floor Broker Management System. Advice C-3 is part of the Exchange’s minor rule plan.⁹

⁷ See proposed Rule 1000(b)(14). The Exchange intends to utilize a special order origin code for professional orders. The Exchange also proposes to disseminate the professional designator over its new Top of Phlx Options Plus Orders (“TOPO Plus Orders”), which includes disseminated Exchange top-of-market data (including orders, quotes and trades) together with all of the data currently available on the Specialized Order Feed (“SOF”). See Securities Exchange Act Release No. 60877 (October 26, 2009), 74 FR 56255 (October 30, 2009)(SR-Phlx-2009-92).

⁸ Orders for any customer that had an average of more than 390 orders per day during any month of a calendar quarter must be represented as professional orders for the next calendar quarter. Member organizations will be required to conduct a quarterly review and make any appropriate changes to the way in which they are representing orders within five days after the end of each calendar quarter. While member organizations will only be required to review their accounts on a quarterly basis, if during a quarter the Exchange identifies a customer for which orders are being represented as customer orders but that has averaged more than 390 orders per day during a month, the Exchange will notify the member organization and the member organization will be required to change the manner in which it is representing the customer’s orders within five days.

⁹ See Rule 970.

With respect to the fees applicable to professional orders, the Exchange is not proposing to charge differently for professionals at this time, such that professional orders would be subject to the same transaction fees as customers today.

The Exchange believes that identifying professional accounts based upon the average number of orders entered for a beneficial account is an appropriately objective approach that will reasonably distinguish such persons and entities from retail investors. The Exchange proposes the threshold of 390 orders per day on average over a calendar month, because it believes that this number far exceeds the number of orders that are entered by retail investors in a single day,¹⁰ while being a sufficiently low number of orders to cover the professional account holders that are competing with broker-dealers in the Phlx marketplace. In addition, basing the standard on the number of orders that are entered in listed options for a beneficial account(s) assures that professional account holders cannot inappropriately avoid the purpose of the rule by spreading their trading activity over multiple exchanges, and using an average number over a calendar month will prevent gaming of the 390 order threshold.

¹⁰ 390 orders is equal to the total number of orders that a person would place in a day if that person entered one order every minute from market open to market close. Many of the largest retail-oriented electronic brokers offer lower commission rates to customers they define as “active traders.” Publicly available information from the websites of Charles Schwab, Fidelity, TD Ameritrade and optionsXpress all define active trader” as someone who executes only a few options trades per month. The highest required trading activity to qualify as an active trader among these four firms was 35 trades per quarter. See Securities Exchange Act Release No. 57254 at note 11 (which also notes that a study of one of the largest retail-oriented options brokerage firms indicated that on a typical trading day, options orders were entered with respect to 5,922 different customer accounts. There was only one order entered with respect to 3,765 of the 5,922 different customer accounts on this day, and there were only 17 customer accounts with respect to which more than ten orders were entered. The highest number of orders entered with respect to any one account over the course of an entire week was 27.).

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act¹¹ in general, and furthers the objectives of Section 6(b)(5) of the Act¹² 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. In particular, the proposal should assure that retail investors continue to receive the appropriate marketplace advantages in the Phlx marketplace, while furthering fair competition among marketplace professionals.

In addition, Section 11(a) of the Act prohibits any member of a national securities exchange from effecting transactions on that exchange for its own account, the account of an associated person, or an account over which it or its associated persons exercises discretion, unless an exemption applies.¹³ Section 11(a)(1) contains a number of exceptions for principal transactions by members and their associated persons. One such exception, set forth in subparagraph (G) of Section 11(a)(1) and in Rule 11a1-1(T),¹⁴ permits any transaction for a member's own account provided, among other things, that the transaction yields priority, parity, and precedence to orders for the account of persons who are not members or associated with members of the exchange. Exchange rules, therefore, may require members to yield priority to non-members, including public customers, to satisfy this exception to Section 11(a).¹⁵ Another

¹¹ 15 U.S.C. 78f(b).

¹² 15 U.S.C. 78f(b)(5).

¹³ 15 U.S.C. 78k(a).

¹⁴ 17 CFR 240.11a1-1(T).

¹⁵ See Phlx Rule 1014.

exception, found in Section 11(a)(1)(A), permits market makers to effect transactions on exchanges in which they are members.¹⁶

In addition to the exceptions noted above, Rule 11a2-2(T) under the Act¹⁷ provides exchange members with an exception from the prohibitions in Section 11(a). Rule 11a2-2(T), known as the "effect versus execute" rule, permits an exchange member, subject to certain conditions, to effect transactions for his own account, the account of an associated person or an account with respect to which it or an associated person thereof exercises investment discretion (collectively, "covered accounts") by arranging for an unaffiliated member to execute the transaction on the exchange.

To comply with the "effect versus execute" rule's conditions, a member: (i) must transmit the order from off the exchange floor; (ii) may not participate in the execution of the transaction once it has been transmitted to the member performing the execution;¹⁸ (iii) may not be affiliated with the executing member; and (iv) with respect to an account over which the member has investment discretion, neither the member nor its associated person may retain any compensation in connection with effecting the transaction except as provided in the rule.¹⁹

As applied to the Exchange's electronic trading platform, Phlx XL II, the Exchange does not believe that the proposal relating to professional orders would affect the availability of the

¹⁶ 15 U.S.C. 78k(a)(1)(A).

¹⁷ 17 CFR 240.11a2-2(T).

¹⁸ The member may, however, participate in clearing and settling the transaction. See Securities Exchange Act Release No. 14563 (March 14, 1978), 43 FR 11542 (March 17, 1978)

¹⁹ 17 CFR 240.11a2-2(T).

exceptions to Section 11(a) of the Act, including the exceptions in subparagraph (G) of Section 11(a) and in Rules 11a1-1(T) and 11a2-2(T), as are currently available.²⁰

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.

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 35 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 self-regulatory organization consents, the Commission will:

- (A) By order approve 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

²⁰ See Securities Exchange Act Release No. 59995 (May 28, 2009), 74 FR 26750 (June 3, 2009) (SR-Phlx-2009-32).

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-Phlx-2010-05 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-Phlx-2010-05. 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 Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission,²¹ 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 inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. 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

²¹ The text of the proposed rule change is available on Phlx's Web site at <http://nasdaqomxphlx.cchwallstreet.com/NASDAQOMXPHLX/Filings>, on the Commission's Web site at <http://www.sec.gov>, at Phlx, and at the Commission's Public Reference Room.

that you wish to make available publicly. All submissions should refer to File Number SR-Phlx-2010-05 and should be submitted on or before [insert date 21 days after publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²²

Florence E. Harmon
Deputy Secretary

²² 17 CFR 200.30-3(a)(12).