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SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-78129; File No. SR- Phlx-2016-67)

June 22, 2016

Self-Regulatory Organizations; NASDAQ PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to the Risk Monitor Mechanism

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 June 9, 2016, NASDAQ PHLX LLC (“Exchange”) filed with the Securities and Exchange Commission (“SEC” or “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 proposal to amend Rule 1095, entitled “Automated Removal of Quotes.”

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

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in

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

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

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 Exchange proposes to amend Rule 1095, entitled “Automated Removal of Quotes” to modify the minimum Specified Percentage (as described below) determined by a Market Maker<sup>3</sup> to enable a Market Maker to enhance their risk management for an underlying security as market conditions warrant, based on their own risk tolerance level and quoting behavior. The manner in which Rule 1095 operates is not being amended in this rule change. The Exchange proposes to permit the Market Maker to set the Specified Percentage more broadly, at not less than 1% with this rule change. The Exchange also proposes to memorialize the definition of disseminated size in the rule text.

Background

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<sup>3</sup> Market Makers include Specialists and Registered Options Traders or “ROTs.” An ROT is defined in Exchange Rule 1014(b) as a regular member or a foreign currency options participant 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 Streaming Quote Traders or “SQTs” and Remote Streaming Quote Traders or “RSQTs” as well as on and off-floor ROTS. An SQT is defined in Exchange Rule 1014(b)(ii)(A) as 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 RSQT is defined in Exchange Rule in 1014(b)(ii)(B) as an ROT that is a member affiliated with an 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 Remote Streaming Quote Trader Organization or “RSQTO,” which may also be referred to as a Remote Market Making Organization (“RMO”), is a member organization in good standing that satisfies the RSQTO readiness requirements in Rule 507(a). RSQTs may also be referred to as Remote Market Markers (“RMMs”).

Today, Rule 1095 permits Market Makers to monitor risk arising from multiple executions across multiple options series of a single underlying security. A Market Maker may provide a specified time period and a specified percentage by which the Exchange's Phlx XL System ("System") will automatically remove a Market Maker's quotes in all series of an underlying security submitted through designated Phlx protocols, as specified by the Exchange, during a specified time period not to exceed 15 seconds ("Percentage-Based Specified Time Period").<sup>4</sup>

For each series in an option, the System determines: (i) the percentage that the number of contracts executed in that series represents relative to the Market Maker's disseminated<sup>5</sup> size of each side in that series ("Series Percentage"); and (ii) the sum of the Series Percentage in the option issue ("Issue Percentage"). The System tracks and calculates the net impact of positions in the same option issue during the Percentage-Based Specified Time Period. The System tracks transactions, i.e., the sum of buy-side put percentages, the sum of sell-side put percentages, the sum of buy-side call percentages, and the sum of sell-side call percentages, and then calculates the absolute value of the difference between the buy-side puts and the sell-side puts plus the absolute value of the difference between the buy-side calls and the sell-side calls. If the Issue Percentage, rounded to the nearest integer, equals or exceeds a percentage established by the Market Maker, not less than 100% ("Specified Percentage"), the System automatically removes a Market Maker's quotes in all series of an underlying security submitted through designated Phlx protocols, as specified by the Exchange, during the Percentage-Based Specified Time. The

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<sup>4</sup> A specified time period commences for an option when a transaction occurs in any series in such option.

<sup>5</sup> The disseminated size is the original size quoted by the Market Maker.

Exchange counts Specialized Quote Feed (“SQF”)<sup>6</sup> quotes only in determining the number of contracts traded and removed by the System.

The Percentage-Based Specified Time Period commences for an option every time an execution occurs in any series in such option and continues until the System removes quotes as described in current Rule 1095(iv) or (v) or the Percentage-Based Time Period expires. The Percentage-Based Specified Time Period operates on a rolling basis among all series in an option in that there may be multiple Percentage-Based Specified Time Periods occurring simultaneously and such Percentage-Based Specified Time periods may overlap.

#### Proposal

The Exchange proposes to lower the Specified Percentage from 100% to 1%. The proposal would provide that if the Issue Percentage, rounded to the nearest integer, equals or exceeds a percentage established by the Market Maker, not less than 1% (“Specified Percentage”), the System automatically removes a Market Maker’s quotes in all series of an underlying security submitted through designated Phlx protocols, as specified by the Exchange, during the Percentage-Based Specified Time. This proposal would allow a Market Maker to establish a Specified Percentage at any percentage level no less than 1% for an option in which the Market Maker is appointed. Today, the Specified Percentage would be set at greater than or equal to 100%. This amendment will allow Market Makers to better manage their risk and assist them to avoid trading a number of contracts that exceeds the Market Maker’s risk tolerance level across multiple series of a single underlying when such series are executed in rapid succession.

Market Makers will be able to more precisely customize their risk management within the System, taking into account such factors as present and anticipated market conditions, news

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<sup>6</sup> SQF permits the receipt of quotes. SQF Auction Responses and market sweeps are also not included.

in an option sudden change in volatility of an option without any limitation regarding the Specified Percentage. Market Makers will be able to adopt more precise controls based on the Market Maker's risk tolerance level.

Market Makers must utilize either the Percentage-Based<sup>7</sup> or Volume-Based risk controls. Market Makers must contact Market Operations to set their percentage and specified time period.

By way of example, if a Market Maker has a rapid fire percentage setting of 50% and a Specified Time Period of 15 seconds and the Order Book reflects:

MM 1 has a displayed quote of 1.10 (100) x 1.20 (100) for IBM May 20, 2016 70 puts and MM1 is the only displayed size on Phlx and an order is submitted to buy 75 IBM May 20, 2016 70 Puts for 1.20

Rule 1095 would:

- (1) Provide MM1 with an execution --Sld 75 @ 1.20; and
- (2) Trigger the Percentage-Based Threshold and remove MM1's quotes in IBM.

Another example is with multiple executions. Presume MM1 has a rapid fire percentage setting of 80% by 5 seconds and MM1 has a displayed quote of 2.00 (100) x 2.25 (100) for IBM May 20, 2016 70 puts and he is the only displayed size on the Phlx. Also, presume an order comes in to buy 50 IBM May 20, 2016 70 puts for 2.25. The following executions would result:

MM1 receives an execution Sold 50 @ 2.25  
MM1 quote updates to 2.00 (100) x 2.25 (50)  
Within 1 second an order comes in to buy 45 IBM May 20, 2016 70 puts for 2.25  
MM1 receives an execution Sold 45 @ 2.25  
MM1 receives rapid fire for IBM

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<sup>7</sup>

Market Makers selecting the Percentage-Based risk control in Rule 1095(i) are required to provide a specified time period, up to 15 seconds, and a specified percentage with a number of 1% or greater, as proposed herein, to the Market Operations staff to select this risk control. If a Market Maker does not desire to utilize the Percentage-Based risk control the Market Maker must utilize the Volume-Based risk control. Market Makers must set-up their risk control settings initially, when they become a Phlx Market Maker, and then subsequent changes by contacting Market Operations.

The Exchange also proposes to memorialize the definition of disseminated size, which is the original size quoted by the Market Maker, within Rule 1095.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>8</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>9</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest.

Market Makers are obligated to submit continuous two-sided quotations in a certain number of series in their appointed option classes for a certain percentage of each trading session,<sup>10</sup> rendering them vulnerable to risk from unusual market condition, volatility in specific options, and other market events that may cause them to receive multiple, extremely rapid automatic executions before they can adjust their quotations and overall risk exposure in the market. Without adequate risk management tools in place on the Exchange, the incentive for Market Makers to quote aggressively, respecting both price and size could be diminished. Such a result may undermine the quality of the markets, which are enhanced by the depth and liquidity such Market Makers provide in the marketplace.

By allowing the percentage to be reduced from 100% to 1%, the Exchange provides its Market Makers the desired flexibility to take into account such factors as present and anticipated market conditions, news in an option or sudden change in volatility of an option without any

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

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

<sup>10</sup> See Rule 1014 titled “Obligations and Restrictions Applicable to Specialists and Registered Options Traders.”

limitation regarding the Specified Percentage. This should encourage Market Makers to provide additional depth and liquidity to the Exchange's markets, thereby removing impediments to and perfecting the mechanisms of a free and open market and a national market system and, in general, protecting investors and the public interest.

The proposal is consistent with the Act because the reduction of the Specified Percentage to not less than 1% provides more alternatives to Market Makers in setting their percentage without impacting their firm quote obligations. The System operates consistently with the firm quote obligations of a broker-dealer pursuant to Rule 602 of Regulation NMS. Specifically, with respect to Market Makers, their obligation to provide continuous two-sided quotes on a daily basis is not diminished by the removal of such quotes by the Percentage-Based Threshold. Market Makers are required to provide continuous two-sided quotes on a daily basis.<sup>11</sup> Market Makers that utilize the Percentage-Based Threshold will not be relieved of the obligation to provide continuous two-sided quotes on a daily basis, nor will it prohibit the Exchange from taking disciplinary action against a Market Maker for failing to meet the continuous quoting obligation each trading day. All quotes entered into the System are considered firm. Quotes will only be removed from the System once the Percentage-Based Threshold has been met if the quote was not otherwise executed by an incoming order.

This risk feature will continue to remove impediments to and perfect the mechanism of a free and open market and a national market system and protect investors and the public interest by allowing Market Makers to remove their quotes in the event that market conditions warrant, based on their own risk tolerance level. Market Makers provide liquidity to the market place and

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<sup>11</sup> Id.

have obligations unlike other market participants.<sup>12</sup> This risk feature is important because it will enable Market Makers to manage their exposure at the Exchange. Further, permitting a broader setting would continue to allow Market Makers to have flexibility in setting their risk exposure to prevent unintended triggers of the Percentage-Based Threshold and it continues to allow Market Makers to set a Specified Time Period. Each Market Maker has different levels of sensitivity and their own system safeguards as well. The proposed setting would permit each Market Maker to select a setting that is appropriate to capture the needs of that Market Maker.

Further, it is important to note that any interest that is executable against a Market Maker's quotes that is received<sup>13</sup> by the Exchange prior to the trigger of the Percentage-Based Threshold, which is processed by the System, automatically executes at the price up to the Market Maker's size. Further, the Purge Notification Message is accepted by the System in the order of receipt in the queue and is processed in that order so that interest that is already accepted into the System is processed prior to the message.

The Exchange notes that Miami International Securities Exchange, LLC ("MIAX") implemented a rule which changed its Allowable Engagement Percentage from 100% to any percentage established by the Market Maker.<sup>14</sup> The Phlx rule is similar to MIAX in that a member is required to have a setting, although MIAX has a default setting in place in the instance that no percentage is provided. Market Makers that select the Percentage-Based risk tool must provide the Exchange with a specified time period and a percentage greater than or equal to 1%.

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<sup>12</sup> Id.

<sup>13</sup> The time of receipt for an order or quote is the time such message is processed by the Exchange book.

<sup>14</sup> See Securities Exchange Act Release No. 77817 (May 12, 2016), 81 FR 31286 (May 18, 2016) (SR-MIAX-2016-10).

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The Percentage-Based Threshold is meant to protect Market Makers from inadvertent exposure to excessive risk. This proposal will foster competition by providing Exchange Market Makers with the ability to enhance and customize their percentage in order to compete for executions and order flow. Specifically, the proposal does not impose a burden on intra-market or inter-market competition, rather, it provides Market Makers with the opportunity to avail themselves of similar risk tools which are currently available on other exchanges.<sup>15</sup> Market Makers quote across many series in an option creating the possibility of “rapid fire” executions that can create large, unintended principal positions that expose Market Makers. The Percentage-Based Threshold permits Market Makers to monitor risk arising from multiple executions across multiple options series of a single underlying security.

The Exchange is proposing this rule change to continue to permit Market Makers to reduce their risk in the event the Market Maker is suffering from a system issue or due to the occurrence of unusual or unexpected market activity. Reducing such risk will enable Market Makers to enter quotations without any fear of inadvertent exposure to excessive risk, which in turn will benefit investors through increased liquidity for the execution of their orders. Reducing risk by utilizing the proposed risk protections enables Market Makers, specifically, to enter quotations with larger size, which in turn will benefit investors through increased liquidity for the execution of their orders. Such increased liquidity benefits investors because they receive better prices and because it lowers volatility in the options market.

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<sup>15</sup> See Section 8 of the 19b4.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were either solicited or received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>16</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>17</sup> The Exchange has requested that the Commission waive the thirty-day operative delay so that the proposal may become operative immediately. The Commission believes that waiving the thirty-day operative delay is consistent with the protection of investors and the public interest. The Exchange proposes to change a setting in an existing risk protection feature to enhance market makers' ability to protect against excessive risk arising from multiple executions across multiple options series of a single underlying security. The Commission notes that another options exchange currently has a similar setting for a like risk protection feature for market makers. Therefore, the Commission hereby waives the thirty-day operative delay and designates the proposal effective upon filing.<sup>18</sup>

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<sup>16</sup> 15 U.S.C. 78s(b)(3)(a)(iii).

<sup>17</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

<sup>18</sup> For purposes of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is: (i) necessary or appropriate in the public interest; (ii) for the protection of investors; or (iii) otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-Phlx-2016-67 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-2016-67. 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-2016-67, 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>

Brent J. Fields  
Secretary

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

