



8011-01
SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-81116; File No. SR-Phlx-2017-48)

July 11, 2017

Self-Regulatory Organizations; NASDAQ PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Regarding Quote Mitigation

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on June 30, 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 Phlx Rule 1082, regarding quote mitigation.

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

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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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 Exchange proposes to amend Phlx Rule 1082, entitled "Firm Quotations," to specifically remove Phlx Rule 1082(a)(ii)(C)(4), which process is not currently in effect on Phlx.

Today, Phlx Rule 1082(a)(ii)(C) sets forth the conditions under which Phlx disseminates updated quotations based on changes in the Exchange's disseminated price and/or size. Phlx disseminates an updated bid and offer price, together with the size associated with such bid and offer, when: (1) Phlx's disseminated bid or offer price increases or decreases; (2) the size associated with Phlx's disseminated bid or offer decreases; or (3) the size associated with Phlx's bid (offer) increases by an amount greater than or equal to a percentage (never to exceed 20%)³ of the size associated with the previously disseminated bid (offer);⁴ and (4) automatic executions will decrement the disseminated size by the amount of the automatic execution.

The Exchange notes that it is removing Phlx Rule 1082(a)(ii)(C)(4) because this functionality is not necessary today. By way of background, the Exchange initially adopted the quote mitigation rule text in Phlx Rule 1082(a)(ii)(C)(4) to enhance the

³ Phlx has set its percentage to 10%. See <http://www.nasdaqtrader.com/content/phlxmemos/2007/jan/0197-07.pdf>.

⁴ Such percentage, which would never exceed 20%, would be determined on an issue-by-issue basis by the Exchange and announced to membership via Exchange circular. The percentage size increase necessary to give rise to a refreshed quote may vary from issue to issue, depending, without limitation, on the liquidity, average volume, and average number of quotations submitted in the issue.

ability of Exchange Streaming Quote Traders (“SQTs”),⁵ Remote Streaming Quote Traders (“RSQTs”),⁶ non-SQT ROTs,⁷ and specialists⁸ (collectively, “Phlx XL participants”) to better manage risk by modifying the legacy Phlx XL system⁹ such that when a trade occurred [sic], the Exchange caused the Phlx XL system to decrement the quote size by the number of contracts traded in the affected option series on the side of the market that has traded (*i.e.*, bid size for sell transactions and offer size for buy transactions). At that time, the Exchange did not decrement quotation size in real time¹⁰, rather it updated quotes and executions separately in two applications. The Exchange would update the quote sent to OPRA with each decrement. However with a size increase the Exchange would only update the quote sent to OPRA if it was beyond the

⁵ 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).

⁶ 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).

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

⁸ 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.

⁹ See Securities Exchange Act Release No. 58582 (September 18, 2008), 73 FR 55190 (September 24, 2008) (SR-Phlx-2008-66) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Quotation Size Decrementation).

¹⁰ The Exchange was disseminating a size which was not necessarily on the Exchange’s book.

10% threshold. At this time, a Phlx XL participant, who controlled his or her quotation size, could refresh the size (and price) for which he or she was firm at the disseminated price. Phlx adopted the rule because participants experienced situations where they executed more contracts at a particular price than they intended due to the fact that Phlx XL did not decrement quote size in real time. The rule was intended to ensure that the Exchange's disseminated size was decremented after each trade automatically executed in Phlx XL. Receipt of a revised quote from the affected Phlx XL participant would reset the price and size for that series.¹¹

Phlx subsequently began operating on INET in 2009.¹² With the migration to INET functionality, the Exchange began to decrement quotation size in real time. The Exchange's system considered both updated quotes and executions within the same process in updating OPRA when considering a decrement. Because of the manner in which the INET system architecture decrements on INET, the language in Phlx Rule 1082(a)(ii)(C)(4) is no longer a correct representation of the function of the quote mitigation in place on Phlx.

By way of example, presuming the Phlx quote mitigation is set to 10% and the following sequence occurs:

If Market Maker (MM)1 has a quote of 1.00 (100) x 1.10 (100)

OPRA quote disseminated – 1.00 (100) x 1.10 (100)

A new MM2 sends a quote of 1.00(5) x 1.10 (5). Because the quote is not increased by 10%, no new OPRA Quote is disseminated. The new Phlx book would be

¹¹ See note 5, *supra*.

¹² See Options Trader Alert #2009 – 17.

1.00 (105) x 1.10 (105) pursuant to Phlx Rule 1082(a)(ii)(C) both before and after the system was migrated to INET.

Case (1): Presuming an incoming buy order of 5 contracts trades on INET- with MM1 trading a 4 lot and MM2 trading a 1 lot. If Phlx Rule 1082(a)(ii)(C)(4) did not exist, with net disseminated size at 100, no OPRA quote update would be disseminated because the current offer did not change as it is not over 10% and the last update remains at 1.00 (100) x 1.10(100). This would be the manner in which the system would continue to work with this rule proposal. The new Phlx book would be 1.00 (100) x 1.10 (100) pursuant to Phlx Rule 1082(a)(ii)(C)(4). This scenario would be same for any buy order of 5 contracts or less since any execution of 5 contracts or less would not decrement the last OPRA quote size of 100 contracts.

With Phlx Rule 1082(a)(ii)(C)(4) employed on legacy PHLX (prior to INET), the incoming buy order of 5 contracts would cause the disseminated size to be decremented by the amount of the automatic execution. Since the prior OPRA quote was 1.00 (100) x 1.10 (100), the OPRA quote update would have been disseminated at 1.00 (100) x 1.10 (95) to reflect the automatic execution of 5 contracts at 1.10.

Case (2): Presuming an incoming buy order of 6 contracts total trades with MM1 trading a 5 lot and MM2 trading a 1 lot, this execution causes the net book size to be decremented from 105 contracts to 99 contracts and the OPRA quote would be disseminated because the size associated with Phlx's disseminated offer decreased. The new updated OPRA quote would be 1.00 (105) x 1.10 (99) which also reflects the new Phlx book of 1.00 (105) x 1.10 (99) pursuant to Phlx Rule 1082(a)(ii)(C)(2). This

scenario would be same for any buy order of more than 5 contracts since an execution of more than 5 contracts would cause the Phlx disseminated offer to decrease.

With Phlx Rule 1082(a)(ii)(C)(4) employed on the legacy Phlx system, the OPRA quote update in Case 2 would have been disseminated at 1.00 (100) x 1.10 (94).

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,¹³ in general, and furthers the objectives of Section 6(b)(5) of the Act,¹⁴ in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest, by continuing to reduce the number of options quotations required to be submitted to OPRA and, therefore, mitigating the Exchange's quote message traffic and capacity. By removing Phlx Rule 1082(a)(ii)(C)(4), the Exchange will update its rule to better describe the current functionality and remove obsolete language. By way of background, when the Exchange initially adopted the rule text in Phlx Rule 1082(a)(ii)(C)(4) Phlx XL, its operating system at the time, did not decrement quotation size in real time meaning that the Exchange's legacy XL system did not consider both updated quotes and executions within the same process when updating OPRA. Phlx Rule 1082(a)(ii)(C)(4) ensured the Exchange's disseminated size was decremented after each trade automatically executed in Phlx XL. Phlx subsequently began operating on INET, thereby rendering Phlx Rule 1082(a)(ii)(C)(4) no longer necessary because of the real-time features which exist on INET which dynamically update and/or purge quotes. At the time of the migration, the

¹³ 15 U.S.C. 78f(b).

¹⁴ 15 U.S.C. 78f(b)(5).

Exchange's system considered both updated quotes and executions within the same process in updating OPRA. This represents the current functionality today. The Exchange believes that the amendment to the rule will provide greater clarity as to the Exchange's plan for quote mitigation.

The Exchange believes that deleting the provision in Phlx Rule 1082(a)(ii)(C)(4) is consistent with the Act in that it removes impediments to and perfect the mechanism of a free and open market and a national market system because the Exchange may have unintentionally disseminated a size which was not necessarily on the Exchange's book. The Exchange believes that Phlx's quote mitigation process has successfully controlled Phlx's quote capacity. The Exchange believes that the removal of the rule text is consistent with the Act because the removal of this rule text will align the functionality of quote mitigation with the language of the rule and properly update OPRA. With the removal of the language, the Exchange's rule properly represents its current function which decrements from a quote actually on the Exchange's book.

Notwithstanding the removal of this provision from the rule, the Exchange will continue to mitigate quotes and monitor its quote capacity, as is the case today. The Exchange believes that Phlx's quote mitigation process has successfully controlled Phlx's quote capacity. The Exchange believes that the removal of the rule text will not impact the effectiveness of quote mitigation.

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 Exchange proposal will better reflect its current quote mitigation process which

applies to all options trading on Phlx. All options exchanges have a quote mitigation process in place in connection with their participation in the Penny Pilot Program.

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 Act¹⁵ and subparagraph (f)(6) of Rule 19b-4 thereunder.¹⁶

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.

¹⁵ 15 U.S.C. 78s(b)(3)(A)(iii).

¹⁶ 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.

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. Please include File Number SR-Phlx-2017-48 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-2017-48. 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, 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-2017-48 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.¹⁷

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¹⁷ 17 CFR 200.30-3(a)(12).

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