



8011-01
SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-82866; File No. SR-Phlx-2018-20)

March 13, 2018

Self-Regulatory Organizations; Nasdaq PHLX LLC; Notice of Filing of Proposed Rule Change to a Proposal to Amend Rule 1079, FLEX Index, Equity and Currency Options and Rule 1059, Accommodation Transactions

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 February 28, 2018, 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 a proposal to amend Rule 1079, FLEX Index, Equity and Currency Options and Rule 1059, Accommodation Transactions.

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 the places specified in

¹ 15 U.S.C. 78s(b)(1).

² 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 Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend Rule 1079 governing FLEX option transactions in order to permit open FLEX option positions to be closed pursuant to Rule 1059, Accommodation Transactions, which provides for cabinet trading³ and which is sometimes referred to as the “cabinet rule”. Conforming changes are proposed to be made to Rule 1059 itself.

FLEX options are currently traded on the Exchange pursuant to the procedures set forth in Rule 1079 which permit market participants to customize equity options to fit specific investment strategies and goals. Rule 1079 allows investors to specify characteristics such as the expiration date, strike price, and exercise-style of FLEX option contracts. Rule 1079(a)(4) governs the quote format of FLEX trades, requiring bids and offers to be made pursuant to Rule 1034 which specifies minimum increments.⁴

³ Currently cabinet or accommodation trading of option contracts is intended to accommodate persons wishing to effect closing transactions in those series of options dealt in on the Exchange for which there is no auction market. An accommodation or cabinet trade refers to trades in listed options on the Exchange that are worthless or not actively traded, often times conducted to establish tax losses. Cabinet or accommodation trading of option contracts is currently intended to accommodate persons wishing to effect closing transactions in those series of options dealt in on the Exchange for which there is no auction market. A cabinet trade is a transaction in which the per-contract value of the cabinet trade is less than the per-contract value of a trade at the specified minimum increment for the option contract. The current proposal would extend the availability of cabinet trading to FLEX options in certain circumstances.

⁴ Rule 1034(a) provides for quote formats “(A) in the case of FLEX index options and equity options, a bid and/or offer in the form of a decimal price (e.g. .10 or .25), pursuant to Rule 1034, a specific dollar amount, or a percentage of the underlying equivalent value, in the case of FLEX index options, or security, in the case of FLEX equity options, rounded to the nearest minimum increment; or (B) in the case of FLEX currency options,

An “accommodation” or “cabinet” trade refers to trades in listed options on the Exchange that are of minimal value or are not actively traded. Cabinet trading is generally conducted in accordance with Exchange Rules except as provided in Rule 1059 which sets forth specific procedures for cabinet trades. Rule 1059(a) provides that a cabinet order is a closing limit order at a price of \$1 per option contract for the account of a customer, firm, specialist or ROT.⁵ The rule provides that an opening order is not a cabinet order, but may in certain cases be matched with a cabinet order.

Phlx now proposes new Rule 1079(g), which would provide that open FLEX option positions are eligible to be closed in cabinet trades under Rule 1059. The proposed new rule would specify that the FLEX option cabinet order may be executed against contraside interest to close a FLEX option position or, to the extent permitted under Rule 1059(a)(iii), against contraside interest which opens a FLEX option position. Under the new rule Sections (a) and (b) of Rule 1079 would not apply to FLEX option transactions executed pursuant to Rule 1079(g) and Rule 1059, while Sections (c) – (g) of Rule 1079 would continue to apply to any FLEX option position opened pursuant to Rule 1059.⁶

in the form of dollars per unit of underlying foreign currency in the minimum increments set forth for U.S. dollar settled foreign currency options in Rule 1034(a).”

⁵ Commentary .02 to Rule 1059 provides that limit orders with a price of at least \$0 but less than \$1 per option contract may also trade under the terms and conditions in Rule 1059, subject to certain limitations.

⁶ Rule 1079(a), Characteristics, sets forth the potential characteristics (including, for example, underlying interest, type, exercise price, quote format, exercise style, and expiration date) of FLEX options and is inapplicable to and unnecessary for cabinet trade closing of FLEX option positions whose characteristics are already known. Other provisions of Rule 1079(a) which define certain aspects of the FLEX request for quote (RFQ) process as well as Rule 1079(b), Procedure for Quoting and Trading FLEX Options, are likewise inapplicable, given that trading FLEX Options in the cabinet would instead be governed by the Rule 1059 cabinet trading rules. Rule 1079 Section (c), Who May Trade FLEX Options, would continue to apply and would restrict participation in FLEX cabinet trades to the entities meeting the requirements of that section. Rule 1079

New, conforming Commentary language would also be added to Rule 1059. Proposed new Rule 1059 Commentary .03 would specify that, pursuant to Rule 1079(g), open FLEX option positions are eligible to be closed in accordance with Rule 1059 at the minimum increments specified therein. The Commentary would state that a FLEX option cabinet order could be executed against contraside interest which itself closes a FLEX option position or, to the extent permitted under Rule 1059(a)(iii), against contraside interest which opens a FLEX option position. Thus, as proposed, the new language would require the initiating side of each FLEX cabinet trade to be a closing transaction, and would permit cabinet trading which opens FLEX positions to occur only as and when already permitted under Rule 1059's existing priority rules for non-FLEX cabinet trades. Language would be added to Rule 1059 Commentary .03 paralleling the last two sentences of proposed Rule 1079(g) which detail the provisions of Rule 1079 that shall not apply to FLEX option transactions executed pursuant to Rule 1079(g) and Rule 1059, as well as the provisions of Rule 1079 that shall apply to FLEX option positions opened pursuant to Rule 1059.

Proposed new Rule 1079(g) would permit an open FLEX option position to be closed through the use of a cabinet order, which would be represented by a floor broker on the floor as specified in Rule 1059(a).⁷ In the past, the Exchange did not provide for the closing of FLEX

Sections (d), Position Limits, (e), Exercise Limits, and (f), relating to the exercise-by-exception procedure of Rule 805 of the Options Clearing Corporation, would continue to apply to any open FLEX position resulting from a FLEX option transaction conducted under Rule 1059.

⁷ Rule 1059(a)(iii) sets forth the manner in which a cabinet order may be either crossed or matched in three different scenarios: first, when the floor broker holds the cabinet order only, second, when the floor broker holds the cabinet order and also a contra-side cabinet order, and third, when the floor broker holds a cabinet order and also a contra-side opening order. Once the cabinet order has been either crossed or matched, the floor broker is required by Rule 1059(a)(iv) to submit the designated cabinet form to the

trades under the cabinet rule due to lack of interest. More recently, market participants have expressed a desire to close FLEX option positions under the cabinet rule and this proposed rule change will permit them to do so. The rule would provide that notwithstanding Rule 1079(a)(4) regarding FLEX Index, Equity and Currency Options minimum increments, open FLEX option positions are eligible to be closed in accordance with Rule 1059, Accommodation Transactions, at the minimum increments specified therein. The Exchange believes that permitting FLEX option positions to be closed pursuant to the cabinet rule will provide FLEX option investors additional flexibility in the maintenance or closing out of their FLEX option positions.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,⁸ in general, and furthers the objectives of Section 6(b)(5) of the Act,⁹ 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 permitting investors who desire to close FLEX options positions the flexibility to do so in a cabinet transaction. The Exchange believes that cabinet trades promote competition and afford market participants greater opportunities to close out their options positions. By providing FLEX options holders the additional flexibility of proposed Rule 1079(g) and Rule 1059 Commentary .03, the Exchange should be able to attract additional FLEX option transactions to the Exchange. The proposed amendments should perfect the mechanism of a free and open market and improve market quality by permitting holders of

Nasdaq Market Operations staff for clearance and reporting at the close of the business day.

⁸ 15 U.S.C. 78f(b).

⁹ 15 U.S.C. 78f(b)(5).

FLEX positions to trade out of those positions more easily and efficiently.

The proposed amendments should perfect the mechanism of a free and open market by stating clearly that Rule 1079(a), Characteristics, and Rule 1079(b), Procedure for Quoting and Trading FLEX Options, will not apply, given that trading FLEX Options in the cabinet would instead be governed by the Rule 1059 cabinet trading rules. Rule 1079 Section (c), Who May Trade FLEX Options, would continue to apply and would restrict participation in FLEX cabinet trades to the entities meeting the requirements of that section. Rule 1079 Sections (d), Position Limits, (e), Exercise Limits, and (f), relating to the exercise-by-exception procedure of Rule 805 of the Options Clearing Corporation, would continue to apply to any open FLEX position resulting from a FLEX option transaction conducted under Rule 1059. Additionally, the proposed language will protect investors and the public interest because Sections (c) – (g) of Rule 1079 shall continue to apply to any FLEX option position opened pursuant to Rule 1059, just as they apply today to FLEX positions opened pursuant to Rule 1079.

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 proposed rule change would allow all market participants holding FLEX option positions the flexibility to close them using the same procedures currently set forth in the cabinet rule for non-FLEX option positions. Permitting FLEX option positions to be closed pursuant to the cabinet rule will provide FLEX option investors additional opportunities to close out their FLEX option positions.

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. Please include File Number SR-Phlx-2018-20 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-2018-20. 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. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-Phlx-2018-20 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.¹⁰

Eduardo A. Aleman
Assistant Secretary

¹⁰ 17 CFR 200.30-3(a)(12).

