



8011-01p

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-83141; File No. SR-Phlx-2018-32]

Self-Regulatory Organizations; Nasdaq PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Adopt a New Market Order Spread Protection May 1, 2018.

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 April 20, 2018, Nasdaq PHLX LLC (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“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 adopt a new Market Order Spread Protection.

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 purpose of this rule change is to adopt a new Market Order Spread Protection rule similar to The Nasdaq Options Market LLC ("NOM").³ The Exchange also proposes an amendment to Rule 1099, entitled "Order Protections."

Today, Phlx Rule 1099 includes various order protections which apply only to simple orders. The Exchange is proposing to amend Rule 1099 to include rule text which makes clear that the order protections within Rule 1099 apply only to simple orders. Further, the Exchange proposes to adopt Market Order Spread Protection functionality within Rule 1099(d), which protection would similarly apply only to simple orders.

This new mandatory risk protection entitled Market Order Spread Protection protects Market Orders⁴ from being executed in very wide markets. This feature would be set at the same preset threshold⁵ for all options traded on Phlx. The proposed new rule provides that a Market Order will be rejected if the best of the NBBO and the internal market PBBO⁶ is wider than a preset threshold, which is selected by the Exchange and announced to members, at the time the Market Order is received by the System. NOM has two non-displayed order types, Price-

³ See NOM Rules at Chapter VI, Section 6(c).

⁴ Market Orders are orders to buy or sell at the best price available at the time of execution.

⁵ This preset threshold would initially be \$5, as explained in more detail below.

⁶ This is the best bid and offer on the Phlx order book including non-displayed legging and stop orders. Resting AON orders are not considered as part of the internal market PBBO in applying the Market Order Spread Protection. Resting AON orders may be passed by in allocation if the incoming order does have sufficient quantity to satisfy the resting AON.

Improving and Post-Only Orders, which may cause the order book on NOM to be better than the NBBO. Phlx similarly has non-displayed order types, all-or-none,⁷ stop orders⁸ and legging orders⁹ (collectively “Non-Displayed Orders”). These Non-Displayed Orders may cause the order book on Phlx to be better than the NBBO. The Exchange also notes that orders which lock or cross another market¹⁰ will cause the PBBO to reprice and also could result in the internal market PBBO being better than the NBBO. The Exchange notes that Non-Displayed Orders would be considered when validating orders on entry for the proposed Market Order Spread Protection, except for all-or-none orders. All-or-none orders have a quantity contingency requiring the full quantity of the order to execute in order for any trade to take place, which may cause the order to not execute. If an all-or-none contingency cannot be met, the all-or-none order would be bypassed until such time as the contingency could be met. For this reason, an all-or-none order will not be considered during the validation of orders on entry for purposes of Market Order Spread Protection. Below are some examples:

⁷ An all-or-none order is a limit or market order that is to be executed in its entirety or not at all.

⁸ A stop order is a limit or market order to buy or sell at a limit price when a trade or quote on the Exchange for a particular option contract reaches a specified price. A stop-market or stop-limit order shall not be elected by a trade that is reported late or out of sequence or by a complex order trading with another complex order.

⁹ A legging order is a limit order on the regular order book in an individual series that represents one leg of a two-legged Complex Order (which improves the cPBBO) that is to buy or sell an equal quantity of two options series resting on the CBOOK. Legging orders are firm orders that are included in the Exchange’s displayed best bid or offer. Legging orders are not routable and are limit orders with a time-in-force of DAY, as they represent an individual component of a Complex Order. Legging orders are non-displayed orders that are automatically generated. See Phlx Rule 1098(f)(iii)(C).

¹⁰ Options Order Protection and Locked and Crossed Market Rules are located at Phlx Rule 1083. In the event of a locked and crossed market, the PBBO will be repriced and displayed in accordance with Phlx Rule 1082(a)(ii)(3)(g)(v).

Example No. 1:

If the Market Order Spread Protection threshold is set to \$5.00, and a Market Order to buy is received while the NBBO and internal PBBO are both \$1.00 - \$6.05 and there are no Non-Displayed Orders resting on the book, such Market Order will be rejected. . [sic]

Example No. 2:

The following is an example of how a legging order interacts with the Market Order Spread Protection. Assume an option minimum price increment (MPV) is scaled in \$0.05 increments and a limit buy order of \$0.05 exists on the Exchange. If the system generates a legging order to sell at \$ 0.11, this order will not be displayed at its limit of \$0.11, because the order is priced at a non-MPV increment. This order will be displayed at the nearest MPV price of \$0.15 (because of the option's \$0.05 MPV increment). Thus, the displayed spread is \$0.10; however the PBBO is \$0.06. Assume this order makes up the best offer on the Exchange. For this example, assume the Market Order Spread Threshold in the System is set at \$ 0.09. Further assume a Market Order to buy is submitted to the Exchange. Based on the Exchange's proposed implementation of Market Order Spread Protection, the Market Order to buy would execute against the resting sell order at \$0.11, since \$0.11 is the best available offer and the internal market PBBO spread is \$0.06 (spread between the best bid of \$0.05 and the best offer of \$ 0.11) which is less than the Market Order Spread Threshold of \$0.09.

Example No. 3:

The following is an example of how an all-or-none order interacts with Market Order Spread Protection. Assume an NBBO: 0 x 5.50 and a PBBO of 0 x 5.45. Also assume an all-or-none order is resting in the order book to sell 1000 at 4.95 and an incoming Market Order to buy 10. The all-or-none order would not be considered in the validation and the incoming Market Order would be rejected. In this example, if the all-or-none order had been considered in the

validation that Market Order would have executed at 5.45, an inferior price because the full quantity of the resting all-or-none order could not be satisfied.

The proposed feature would assist with the maintenance of fair and orderly markets by ensuring that the best bid and offer displayed on the Exchange are within a reasonable range and preventing market orders from trading outside of the reasonable range when the best bid and offer displayed are not within the allowable range. The Exchange proposes this feature to avoid executions of Market Orders when the market is too wide for a reasonable execution.

Today, the NOM threshold is set at \$5. Phlx will initially set the threshold to \$5. Similar to NOM, the Exchange will notify Members of the threshold with advanced notice to members through an Options Trader Alert, and, thereafter, members will be notified in advance of any subsequent changes to the threshold. NOM set the differential at \$5 to match the bid/ask differential permitted for quotes on the Exchange.¹¹ The Exchange would consider a subsequent change to the threshold if it believed that the \$5 initial threshold was too wide or too restrictive as between the bid and offer to create a reasonable range for executions. Phlx has the same differential.¹² Thus, the presence of a quote on the Exchange will ensure the NBBO is at least \$5 wide. The Exchange believes the presence of a quote on the Exchange, or a bid/ask differential of the NBBO, which is no more than \$5 wide affords Market Orders proper protection against erroneous execution and in the event a bid/ask differential is more than \$5, then a Market Order

¹¹ See Chapter VII, Section 6(d)(ii) of NOM Rules which describes the bid/ask differentials. Options on equities (including Exchange-Traded Fund Shares), and on index options must be quoted with a difference not to exceed \$5 between the bid and offer regardless of the price of the bid, including before and during the opening. However, respecting in-the-money series where the market for the underlying security is wider than \$5, the bid/ask differential may be as wide as the quotation for the underlying security on the primary market. The Exchange may establish differences other than the above for one or more series or classes of options.

¹² See Phlx Rule 1014(c)(i)(A)(2).

is rejected. The threshold is appropriate because it seeks to ensure that the displayed bid and offer are within reasonable ranges and do not represent erroneous prices. The protection would reject Market Orders which are outside of the parameters of the Market Order Spread Protection. The Exchange's proposed threshold is a reasonable measure to ensure prices remain within the preset threshold set by the Exchange, which will be initially set at \$5. This protection will bolster the normal resilience and market behavior that persistently produces robust reference prices. This feature should create a level of protection that prevents Market Orders from entering the Order Book outside of an acceptable range for the Market Order to execute.

Finally, the Market Order Spread Protection will be the same for all options traded on the Exchange, and is applicable to all Members that submit Market Orders. The Market Order Spread Protection would not apply during the Opening Process and trading halts, similar to the manner in which it operates today on NOM. Both the Opening Process and trading halts have their own more restrictive boundaries than those proposed for the Market Order Spread Protection. With respect to the Opening Process, a Quality Opening Market is required. A Quality Opening Market requires a bid/ask differential applicable to the best bid and offer from all Valid Width Quotes defined in a table¹³ to be determined by the Exchange.¹⁴ The Exchange's requirements during the Opening Process are more restrictive than the proposed initial setting for the Market Order Spread Protection, which is proposed at \$5. As provided in Phlx Rule 1047(g),

¹³ The table is published on the Exchange's website at:
http://www.nasdaqtrader.com/content/phlx/phlx_systemtime.pdf.

¹⁴ The calculation of Quality Opening Market is based on the best bid and offer of Valid Width Quotes. The differential between the best bid and offer are compared to reach this determination. The allowable differential, as determined by the Exchange, takes into account the type of security (for example, Penny Pilot versus non-Penny Pilot issue), volatility, option premium, and liquidity. The Quality Opening Market differential is intended to ensure the price at which the Exchange opens reflects current market conditions. See Phlx Rule 1017(a)(viii).

trading halts are subject to the reopening process as provided for in Phlx Rule 1017(e). The same protections noted for the Opening Process above will apply for trading halts. The Exchange believes that the Market Order Spread Protection is unnecessary during the Opening Process and during a trading halt because other protections are in place to ensure that the best bid and offer displayed on the Exchange are within a reasonable range.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,¹⁵ in general, and furthers the objectives of Section 6(b)(5) of the Act,¹⁶ in particular, in that it is designed to promote just and equitable principles of trade and to protect investors and the public interest by mitigating risk to market participants. By adopting this mandatory risk protection, similar to NOM, the Exchange will protect market participants from the execution of erroneous Market Orders. The proposed feature would assist with the maintenance of fair and orderly markets by ensuring that the best bid and offer displayed on the Exchange are within a reasonable range and further the protection would prevent market orders from trading outside of the reasonable range when the best bid and offer displayed are not within the allowable range.

This feature should create a level of protection that prevents erroneous Market Orders from entering the Order Book and thereby reduce the negative impacts of sudden, unanticipated volatility, and serve to preserve an orderly market in a transparent and uniform manner, increase overall market confidence, and promote fair and orderly markets and the protection of investors. This feature is not optional and is applicable to all members submitting Market Orders.

Permitting the rejection of the Market Order at the better of the NBBO or Reference PBBO does not otherwise create an impediment to a free and open market because Non-

¹⁵ 15 U.S.C. 78f(b).

¹⁶ 15 U.S.C. 78f(b)(5).

Displayed Orders exist today on NOM with this same protection and provide investors the opportunity to trade at a better price than would otherwise be available, *e.g.* inside the disseminated best bid and offer for a security, which could result in better executions for investors. The Exchange's exclusion of all-or-none orders when validating orders on entry for purposes of Market Order Spread Protection is consistent with the protection of investors and the public interest. This contingency order is already bypassed today for purposes of priority when the contingency cannot be satisfied. The Exchange notes that because all-or-none orders have a size contingency, which may cause this order type not to execute, the result of including the all-or-none order in the validation of incoming orders could result in executions at inferior prices.

The Exchange's proposal to not apply the Market Order Spread Protection during the Opening Process and during is consistent with the Act because protections exist within those mechanisms to ensure that the best bid and offer displayed on the Exchange are within a reasonable range. The Exchange's Opening Process Rule 1017¹⁷ and the Trading Halt Rule 1047¹⁸ both contain more restrictive boundaries than those proposed for the Market Order Spread Protection. With respect to the Opening Process, a Quality Opening Market is required. A Quality Opening Market requires a bid/ask differential applicable to the best bid and offer from all Valid Width Quotes defined in a table to be determined by the Exchange. The Exchange's requirements during the Opening Process are more restrictive than the proposed initial setting for the Market Order Spread Protection, which is proposed at \$5. As provided in Phlx Rule 1047(g),

¹⁷ With respect to the Opening Process, a Quality Opening Market is required. A Quality Opening Market a bid/ask differential applicable to the best bid and offer from all Valid Width Quotes defined in a table to be determined by the Exchange and published on the Exchange's web site. See Phlx Rule 1017(a)(viii).

¹⁸ With respect to trading halts, Opening Process procedures will be used to reopen an option series after a trading halt, therefore, the same protections noted for the Opening Process will apply for a trading halt and the same restrictive boundaries would apply. See Phlx Rule 1017(e).

trading halts are subject to the reopening process as provided for in Phlx Rule 1017(e). The same protections noted for the Opening Process above will apply for trading halts. The Exchange believes that the Market Order Spread Protection is unnecessary during the Opening Process and during a trading halt because other protections are in place to ensure that the best bid and offer displayed on the Exchange are within a reasonable range.

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 believes that the proposed amendments do not impose an undue burden on competition because the Market Order Spread Protection will be mandatory for all market participants. The Market Order Spread Protection feature will provide market participants with additional price protection from anomalous executions. The Exchange does not believe the proposal creates any significant impact on competition.

The Exchange does not believe that accounting for Non-Displayed Orders, except for all-or-none orders, or repricing due to trade-through and locked and crossed market restrictions creates an undue burden on competition because it will serve to provide members with additional information in the rule text to anticipate the impact of the Market Order Spread Protection feature. Today, members are able to submit orders or quotes priced between the MPV for display at the nearest MPV.

The Exchange does not believe that not applying the Market Order Spread Protection during the Opening Process and during a trading halt creates an undue burden on competition because these mechanisms offer more restrictive protections than the proposed initial setting for the Market Order Spread Protection, which is proposed at \$5.

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 Act¹⁹ and subparagraph (f)(6) of Rule 19b-4 thereunder.²⁰

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative for 30 days after the date of its filing. However, Rule 19b-4(f)(6)(iii)²¹ permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has requested that the Commission waive the 30-day operative delay so that the proposed rule change will become operative on filing. The Exchange states that waiver of the 30-day operative delay would allow the Exchange to immediately offer a mandatory risk protection, similar to NOM, for all market participants transacting in simple orders to protect market participants from entering Market Orders outside of a reasonable range for execution. Based on the foregoing, the Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest. Therefore,

¹⁹ 15 U.S.C. 78s(b)(3)(A)(iii).

²⁰ 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, along with a brief description and text of 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.

²¹ 17 CFR 240.19b-4(f)(6)(iii).

the Commission hereby waives the operative delay and designates the proposed rule change operative upon filing.²²

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 necessary or appropriate in the public interest, for the protection of investors, or 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 change 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. Please include File Number SR-Phlx-2018-32 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-2018-32. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your

²² For purposes only of waiving the 30-day operative delay, the Commission also has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

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-2018-32, 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.²³

Eduardo A. Aleman,
Assistant Secretary.

²³ 17 CFR 200.30-3(a)(12).

