

Required fields are shown with yellow backgrounds and asterisks.

Filing by Nasdaq PHLX LLC  
 Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

<b>Initial *</b>	<b>Amendment *</b>	<b>Withdrawal</b>	<b>Section 19(b)(2) *</b>	<b>Section 19(b)(3)(A) *</b>	<b>Section 19(b)(3)(B) *</b>
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
			Rule		
<b>Pilot</b>	<b>Extension of Time Period for Commission Action *</b>	<b>Date Expires *</b>	<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
<input type="checkbox"/>	<input type="checkbox"/>	<input type="text"/>	<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

<b>Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010</b>	<b>Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934</b>
<b>Section 806(e)(1) *</b>	<b>Section 806(e)(2) *</b>
<input type="checkbox"/>	<input type="checkbox"/>
	<b>Section 3C(b)(2) *</b>
	<input type="checkbox"/>

<b>Exhibit 2 Sent As Paper Document</b>	<b>Exhibit 3 Sent As Paper Document</b>
<input type="checkbox"/>	<input type="checkbox"/>

**Description**

Provide a brief description of the action (limit 250 characters, required when Initial is checked \*).

proposal to reserve Rule 1014(g)(vii) and (viii), which describes the allocation of automatically executed trades, and adopt a new Rule 1089 and title that rule Electronic Execution Priority and Processing in the System.

**Contact Information**

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name \*  Last Name \*   
 Title \*   
 E-mail \*   
 Telephone \*  Fax

**Signature**

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

(Title \*)

Date    
 By

(Name \*)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFF website.

**Form 19b-4 Information \***

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change \***

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies \***

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

(a) Nasdaq PHLX LLC (“Phlx” or “Exchange”), 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> is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposal to reserve Rule 1014(g)(vii) and (viii), which describes the allocation of automatically executed trades, and adopt a new Rule 1089 and title that rule “Electronic Execution Priority and Processing in the System.”

A notice of the proposed rule change for publication in the Federal Register is at Exhibit 1. The text of the proposed rule change is at Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Board of Directors of the Exchange (the “Board”) on September 19, 2017. Exchange staff will advise the Board of any action taken pursuant to delegated authority. No other action is necessary for the filing of this rule change.

Questions and comments on the proposed rule change may be directed to:

Angela Saccomandi Dunn  
Principal Associate General Counsel  
Nasdaq, Inc.  
215-496-5692

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

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

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

a. Purpose

The Exchange proposes to remove the current rule text describing the allocation of automatically executed trades from Phlx Rule 1014(g)(vii) and (viii) and, in its place, adopt new Phlx Rule 1089 titled "Electronic Execution Priority and Processing in the System" to describe the manner in which the Exchange will process, prioritize and allocate transactions in the order entry system ("System").<sup>3</sup> In adopting Rule 1089, the Exchange proposes to model the rule on Nasdaq BX, Inc.'s ("BX") "Book Processing" rule at Chapter VI, Section 10.

The current rule text in Rule 1014(g)(vii) provides that after public customer market and marketable limit orders have been executed, trades automatically executed in such options shall be allocated automatically in the following manner:

(A) If the specialist, an SQT, RSQT or a non-SQT ROT that has placed a limit order on the limit order book ("Phlx XL Participant") is quoting alone at the disseminated price and their quote is not matched by another Phlx XL participant prior to execution, such Phlx XL Participant shall be entitled to receive a number of contracts up to the size associated with his/her quotation.

(B) *Parity*. Quotations entered electronically by the specialist, an RSQT or an SQT that do not cause an order resting on the limit order book to become due for execution may be matched at any time by quotations entered electronically by the specialist and/or other SQTs and RSQTs, and by ROT limit orders and shall be deemed to be on parity, subject to the requirement that orders of controlled accounts must yield priority to customer orders as set forth in Rule 1014(g)(i)(A).

Proposed Rule 1089(A) states that the Exchange will apply a Size Pro-Rata execution algorithm, as is the case today, to electronic orders/quotes to each level of

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<sup>3</sup> For purposes of this rule, the term "System" shall mean the automated system for order execution and trade reporting owned and operated by the Exchange.

priority separately, other than Customers.<sup>4</sup> Customers will retain priority over other market participants, as is in the case today. Proposed Rule 1089(A)(1)(i) describes that priority.<sup>5</sup> For purposes of this rule a Customer shall be defined as a person or entity that is not a broker or dealer in securities.

The priority for market makers in current Rule 1014(g)(vii)(A) is described differently in proposed Rule 1089, however the priority treatment remains unchanged from how the system functions today. The new rule describes how the various market makers will be specifically allocated.<sup>6</sup> The rule lays out the order in which the trading

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<sup>4</sup> For example, Size Pro-Rata allocation is applied to market maker priority and separately for all other remaining interest. On Phlx an “Options Market Maker” includes Specialists and Registered Options Traders (“ROTs”) (which includes Streaming Quote Traders (“SQTs”) and Remote Streaming Quote Traders (“RSQTs”)) and floor market makers. A Specialist is an Exchange member who is registered as an options specialist. See Phlx Rule 1020(a). A ROT is a regular member or a foreign currency options participant of the Exchange who has received permission from the Exchange to trade in options for his own account. 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. 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. A floor market maker is known as a non-SQT ROT in Rule 1014(b)(ii)(C). A non-SQT ROT is an ROT who is neither an SQT nor an RSQT.

<sup>5</sup> Customer Priority shall mean that the highest bid and lowest offer shall have priority except that Customer orders shall have priority over non-Customer interest at the same price, provided the Customer order is an executable order. If there are two or more Customer orders for the same options series at the same price, priority shall be afforded to such Customer orders in the sequence in which they are received by the System.

<sup>6</sup> After all Customer orders have been fully executed, upon receipt of an order, provided the Specialist’s bid/offer is at or improves on the Exchange’s disseminated price, the Specialist will be afforded a participation entitlement.

system will allocate trades to the various type of participants. A Specialist shall receive the greater of:

(a) When the Specialist is at the same price with SQT, RSQT or non-SQT ROT (collectively “ROTs”) and the number of contracts is greater than 5, the Specialist is entitled to receive an enhanced participation of at least 30% of the remainder of the order (“Specialist Participation Entitlement”);  
or

(i) 60% of remaining interest if there is one other ROT at that price;

(ii) 40% of remaining interest if there are two other ROTs at that price;

(iii) 30% of remaining interest if there are more than two other ROTs at that price; or

(b) the Specialist’s size pro-rata share under (A)(1)(iv) (“ROT Priority”);  
or

(c) the Directed ROT (“DROT”) participation entitlement, if any, set forth in subsection (A)(1)(iii) below (if the order is a Directed Order and the Specialist is also the DROT) (“DROT Priority”).

Finally, the concept of parity is removed from the new Rule as a separate concept.

The Exchange believes that it is not necessary to discuss allocation in terms of parity.

The outline of the new rule describes the manner in which the trading system will allocate orders to various market participants based on a Size Pro-Rata model. The Exchange notes that the concept of priority is detailed within each section when describing similarly situated market participants. The Exchange believes that removing the rule text related to parity from the proposed rule is consistent with the Act because while the Exchange is not specifically describing parity within the proposed rule, the

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The Specialist shall not be entitled to receive a number of contracts that is greater than the displayed size associated with such Specialist.

Exchange will allocate based on parity as described in more detail within the specific allocations provided for within the proposed rule.

Current Rule 1014(g)(vii)(A)(1)(a) contains the following language for orders of 5 contracts or fewer:

orders for 5 contracts or fewer shall be allocated first to the specialist, provided, however, that on a quarterly basis, the Exchange will evaluate what percentage of the volume executed on the Exchange is comprised of orders for 5 contracts or fewer allocated to specialists, and will reduce the size of the orders included in this provision if such percentage is over 25%. In order to be entitled to receive the 5 contract or fewer order preference set forth in this subparagraph (B)(1)(a), the specialist must be quoting at the Exchange's disseminated price, and shall not be entitled to receive a number of contracts that is greater than the size that is associated with its quote. If the specialist is not quoting at the Exchange's disseminated price at the time of execution, orders for 5 contracts or fewer shall be allocated to Phlx XL Participants on parity as set forth in paragraph (b) below.

The provision for contracts of 5 lots or fewer is carried over into proposed Rule 1089(A)(1)(ii)(2), however the new Rule 1089(A)(1)(ii)(1)(c) provides that if the order, including orders of 5 lots or fewer, is a Directed Order,<sup>7</sup> the Directed Order allocation would apply. This additional clarity will make clear when the Directed Order allocation would be allocated. The language of Rule 1014(g)(vii)(A)(1)(a) is similar to proposed Rule 1089(A)(1)(ii)(2), except that the rule now states, in order to be entitled to receive the 5 contract or fewer order preference set forth in this subparagraph (A)(1)(ii)(2), the

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<sup>7</sup> A Directed Order is defined in 1080(1)(i)(A) as any order (other than a stop or stop-limit order as defined in Rule 1066) to buy or sell which has been directed to a particular specialist, RSQT, or SQT by an Order Flow Provider or "OFP." If the Exchange's disseminated best bid or offer is at the NBBO when the Directed Order is received, the Directed Order is automatically executed on Phlx XL and allocated to the orders and quotes represented in the Exchange's quotation. A Directed Specialist, SQT, or RSQT will receive a participation allocation pursuant to Exchange Rule 1014(g)(viii) if the Directed Specialist, SQT, or RSQT was quoting at the best price on the Exchange which is at or better than the NBBO at the time that the Directed Order was received pursuant to Phlx Rule 1080(1)(ii).

Specialist *must have an quote/order*<sup>8</sup> at the Exchange's disseminated price with no other interest present which has a higher priority, and shall not be entitled to receive a number of contracts that is greater than the size that is associated with its quote. Also, the rule is proposed to state, if the Specialist is not quoting at the Exchange's disseminated *best*<sup>9</sup> price *with no other interest present which has a higher priority at the time of execution, a Specialist is not entitled to priority with respect to the 5 contracts or fewer, however the Specialist is eligible to receive such contracts pursuant to 1089(A)(i)(iv), thereafter orders will be allocated pursuant to 1089(A)(1)(iv).*<sup>10</sup> *This sub-paragraph (A)(1)(ii)(2) shall only apply after the opening and shall not apply to auctions.* The Exchange proposes to add even more specificity to proposed Rule 1089(A)(1)(ii)(2) to note that if a Customer is resting at the Exchange's disseminated best price at the time of execution, a Specialist is not entitled to priority with respect to the 5 contracts or fewer, as is the case today. The Exchange believes that this proposed change is consistent with the Act because the Specialist will not be entitled to priority with respect to the 5 contracts or fewer because there is interest of higher priority resting at the Exchange's disseminated best price or because the Specialist is not quoting at the Exchange's disseminated best

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<sup>8</sup> Today this states must be quoting. The Exchange believes it is more accurate to state have an quote or order as a Specialist may also submit an order.

<sup>9</sup> The addition of the word "best" is a more accurate statement because the interest must be at the best price to be executed.

<sup>10</sup> The current sentence states, "If the specialist is not quoting at the Exchange's disseminated price at the time of execution, orders for 5 contracts or fewer shall be allocated to Phlx XL Participants on parity as set forth in paragraph (b) below." The new sentence proposes additional specificity, as described herein, to reflect that the the Specialist must be at the Exchange's disseminated best price to be entitled to priority with respect to the 5 contracts or fewer, otherwise allocation shall be among other participants at the same price.



price. In these situations, the Specialist will receive ROT priority, and be treated on par with other market makers, pursuant to Rule 1089(A)(1)(iv). The Exchange's proposed rule would not allow for two separate priority allocations. The Exchange notes in proposed Rule 1089(A)(1)(ii)(2) that the provision for contracts of 5 lots or fewer applies only after the Opening Process<sup>11</sup> and does not apply to auctions. This clarifying language is added to the proposed rule to provide more detail as to the manner in which the provision for contracts of 5 lots or fewer is applied.<sup>12</sup> The Exchange believes that the proposed new rule text is consistent with the Act because the new language proposes to make clear when the Specialist is entitled to the 5 lot allocation with more specificity than is in the rule today. The proposed rule text protects investors and the public interest by adding clarifying language to the rule text.

The Exchange proposes to memorialize the manner in which rounding will be handled in proposed Rule 1089(A)(1)(ii). If rounding would result in an allocation of less than one contract, a Specialist will receive one contract. With respect to all other rounding, all rounding is down to the nearest integer. The Exchange believes that rounding down uniformly is consistent with the Exchange Act because it provides for the

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<sup>11</sup> The Opening Process is described at Phlx Rule 1017, entitled "Openings in Options."

<sup>12</sup> For example, the Exchange's PIXL auction and the Opening Process would not be subject to proposed Rule 1089(A)(1)(ii)(1). PIXL<sup>SM</sup> is the Exchange's price improvement mechanism known as Price Improvement XL or PIXL. A member may electronically submit for execution an order it represents as agent on behalf of a public customer, broker-dealer, or any other entity ("PIXL Order") against principal interest or against any other order (except as provided in Rule 1080(n)(i)(E)) it represents as agent ("Initiating Order"), provided it submits the PIXL order for electronic execution into the PIXL Auction pursuant to Rule 1080. See Phlx Rule 1080(n). The Opening Process is explained in Phlx Rule 1017.

equitable allocation of contracts among the Exchange’s market participants. Also, this rule change will provide market participants will transparency as to the number of contracts that they are entitled to receive as the result of rounding. Rule 1014(g)(vii) currently does not address the manner in which the System handles rounding. The Exchange proposes to memorialize in proposed Rule 1089(A) the following language to clarify the manner in which the Exchange handles rounding today, “If the result is not a whole number, it will be rounded down to the nearest whole number.”<sup>13</sup> The Exchange believes that clearly indicating the manner in which rounding occurs within the order book will bring clarity to the allocation process. The Exchange notes that rounding will be uniformly applied to all market participants.

Current Rule 1014 (g)(vii)(A)(1)(b) provides that:

Respecting orders for greater than 5 contracts (regardless of whether the specialist is quoting at the Exchange’s disseminated price), or orders for 5 contracts or fewer when the specialist is not quoting at the Exchange’s disseminated price, inbound electronic orders shall be allocated pursuant to the following allocation algorithm:

$$\frac{\begin{array}{l} \text{Equal percentage based on the} \\ \text{number of Phlx XL} \\ \text{Participants quoting or with} \\ \text{limit orders at BBO} \\ \text{(Component A)} \end{array} + \begin{array}{l} \text{Pro rata percentage based} \\ \text{on size of Phlx XL} \\ \text{participant quotes/limit} \\ \text{orders (Component B)} \end{array}}{2} \times \text{Incoming Order Size}$$

Where:

Component A: The percentage to be used for Component A shall be an equal percentage, derived by dividing 100 by the number of Phlx XL participants quoting at the BBO.

<sup>13</sup> Phlx and BX round differently. BX’s rounds up or down to the nearest integer. See BX Rules at Chapter VI, Section 10 (1)(C)(1)(b)(1).

Component B: Size Pro Rata Allocation. The percentage to be used for Component B of the allocation algorithm formula is that percentage that the size of each Phlx XL Participant's quote at the best price represents relative to the total number of contracts in the disseminated quote.

Final Weighting: The final weighting formula for equity options, which shall be determined by a three-member special committee of the Board of Directors, chaired by the President of the Exchange, and two Directors (the "Special Committee" ), and apply uniformly across all equity options, shall be a weighted average of the percentages derived for Components A and B multiplied by the size of the incoming order. Initially, the weighting of components A and B shall be equal, represented mathematically by the formula:  $(\text{Component A Percentage} + \text{Component B Percentage})/2$  \* incoming order size.

The final weighting formula for index options and options on Exchange Traded Fund Shares (as defined in Rule 1000(b)(42.)) shall be established by the Special Committee. The final weighting formula for options on U.S. dollar-settled foreign currency options shall be established by a three-member special committee of the Board of Directors, chaired by the President of the Exchange, and two Governors. The final weighting formula may vary by product. Changes made to the percentage weightings of Components A and B shall be announced to the membership on the Exchange's website at least one day before implementation of the change.

With respect to this formula, the Exchange notes that the Exchange is replacing this formula with a more streamlined analysis of the manner in which orders will be allocated in the trading system. At this time, the Exchange proposes to eliminate the formula, the weighting process and the ability to determine values for the weighting and simply state that it will apply a Size Pro-Rata execution algorithm to electronic orders.<sup>14</sup> This is the manner in which Phlx allocates today. The Exchange is adopting rule text to memorialize the manner in which the allocation operates today. The Exchange proposes the following rule text to describe the Size-Pro Rata execution algorithm, "The Exchange will apply a Size Pro-Rata execution algorithm to electronic orders. The System shall

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<sup>14</sup> Phlx offers both an electronic and floor model for the execution of options transactions. Floor transactions are subject to Phlx Rule 1014(g)(v).

execute trading interest within the System in price priority, meaning it will execute all trading interest at the best price level within the System before executing trading interest at the next best price.”<sup>15</sup>

The Exchange proposes to clearly define the priority overlays that are currently applied today. Today, the Exchange allocates contracts utilizing a Customer Priority Size Pro-Rata allocation model. First, Customer contracts are allocated in Price-Time priority<sup>16</sup>. Thereafter, the Exchange allocates interest to electronic orders/quotes of Specialists utilizing a Size Pro-Rata allocation model.<sup>17</sup> Lastly, the Exchange allocates interest to off-floor broker dealer orders<sup>18</sup> utilizing a Size Pro-Rata allocation model, which includes orders of all market participants, excluding Customers and Specialists because they have already been allocated. In addition, as part of the Size Pro-Rata allocation to the Specialists and DROTs, the Exchange may apply a Specialist Participation Entitlement or DROT Priority.<sup>19</sup> Each step is described below in greater detail and the addition of new language is addressed below as well.

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<sup>15</sup> See proposed Phlx Rule 1089(A). This rule text is similar to BX Rules at Chapter VI, Section 10(1)(A) and (B) with respect to BX’s Price/Time and Size Pro-Rata execution algorithms.

<sup>16</sup> Price-Time allocations are filled among Customer orders in time priority as described above in this Purpose section.

<sup>17</sup> The Specialist allocation is described above in the Purpose section.

<sup>18</sup> The term “off-floor broker-dealer order” means an order delivered from off the floor of the Exchange by or on behalf of a broker-dealer for the proprietary account(s) of such broker-dealer, including an order for a market maker located on an exchange or trading floor other than the Exchange’s trading floor delivered for the proprietary account(s) of such market maker.

<sup>19</sup> A Specialist or ROT that receives a Directed Order is a DROT. The term “Directed Order” means any order (other than a stop or stop-limit order as defined in Rule 1066) to buy or sell which has been directed to a particular specialist,

*Customer Priority*

As is the case today, Customer orders are always allocated first at a given price. The Exchange will continue to prioritize orders by the highest bid and lowest offer, except that Customer orders shall have priority over non-Customer interest at the same price, provided the Customer order is an executable order.<sup>20</sup> If there are two or more Customer orders for the same options series at the same price, priority shall be afforded to such Customer orders in the sequence in which they are received by the trading system (hereinafter “System”).<sup>21</sup> No participant shall be entitled to receive a number of contracts that is greater than the size that is associated with their quotation or order.

Currently, Customer priority is described at Rule 1014(g)(viii)(A) which refers to Rule 1014(g)(i)(A).<sup>22</sup> The current rule text simply states that public customer market and marketable limit orders are executed first. The Exchange believes that its proposed rule text, which is similar to BX Rules at Chapter VI, Section 10(1)(C)(1)(a), provides more clarity to the current rule text in explaining the manner in which Customer orders are being allocated. The manner in which Customer orders are allocated is not being

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Remote Streaming Quote Trader or “RSQT”, or Streaming Quote Trader or “SQT” by an Order Flow Provider. See Phlx Rule 1080(1)(i)(A).

<sup>20</sup> An executable order would be for example a non-contingent order or a contingent order that can have its contingency satisfied, such as an All-or-none order. All-or-none (“AON”) means a contingency market or limit order which is to be executed in its entirety or not at all. Of note, Customer AON would not be considered a “Protected Bid” or “Protected Offer” pursuant to Phlx Rule 1083(o), because it is non-displayed interest.

<sup>21</sup> See proposed Phlx Rule 1089(A)(1)(i).

<sup>22</sup> Phlx Rule 1014(g)(i)(A) states that equity option, index option and U.S. dollar-settled foreign currency option orders of controlled accounts are required to yield priority to customer orders when competing at the same price. BX Rules at Chapter VI, Section 10(1)(C)(1)(a) similarly prioritizes customer orders first.

amended, simply restated for clarity. For purposes of this Rule, a Customer order does not include a Professional Order.<sup>23</sup> The Exchange believes that is consistent with the protection investors and the public interest to have a rule which clearly spells out the allocation in time of sequence.

*Enhanced Specialist Priority*

Current Rule 1014(g)(vii)(B)(1)(c) describes Enhanced Specialist Participation as follows: “For options subject to the Enhanced Specialist Participation as set forth in Rule 1014(g)(ii), the specialist shall be entitled to receive a number of contracts (not to exceed the size of the specialist’s quote) that is the greater of the amount he would be entitled to receive pursuant to Rule 1014(g)(ii), or the amount he would otherwise receive pursuant to the operation of the algorithm described above.”

The Exchange notes that in proposed Rule 1089(A)(1)(ii), the allocation described in current Rule 1014 g)(vii)(B)(1)(c) is not being amended. After all Customer orders have been fully executed, upon receipt of an order, provided the Specialist’s bid/offer is at or improves on the Exchange’s disseminated price, the Specialists, if any, and ROTs will be afforded entitlements and then to off-floor brokers. The Specialist shall not be entitled to receive a number of contracts that is greater than the displayed size associated

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<sup>23</sup> The term Professional means any 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). A professional will be treated in the same manner as an off-floor broker-dealer for purposes of Rules 1014(g)(except with respect to all-or-none orders, which will be treated like customer orders, except that orders submitted pursuant to Phlx Rule 1080(n) for the beneficial account(s) of professionals with an all-or-none designation will be treated in the same manner as off-floor broker-dealer orders), 1033(e), 1064.02 (except professional orders will be considered customer orders subject to facilitation), 1080(n) and 1080.07 as well as Options Floor Procedure Advices B-6 and F-5. Member organizations must indicate whether orders are for professionals. See Phlx Rule 1000(14).

with such Specialist.<sup>24</sup> Specialist Participation Entitlements are applied throughout the trading day as well as during the Opening Process,<sup>25</sup> except that, pursuant to subparagraph (A)(1)(ii)(2), the entitlement shall only apply after the opening and shall not apply to auctions. The Exchange is adding clarifying language to provide more detail to the current rule.

Proposed Rule 1089 provides that a Specialist shall receive the greater of (1) Specialist Participation Entitlement; (2) ROT Priority or (3) DROT Priority. Today, the Exchange's current rule text states, "For options subject to the Enhanced Specialist Participation as set forth in Rule 1014(g)(ii), the specialist shall be entitled to receive a number of contracts (not to exceed the size of the specialist's quote) that is the greater of the amount he would be entitled to receive pursuant to Rule 1014(g)(ii), or the amount he would otherwise receive pursuant to the operation of the algorithm..."<sup>26</sup> The Exchange would continue to allocate to the Specialist the greater of the (1) Specialist Participation Entitlement or the (2) ROT Priority. The Exchange's proposal adds a new allocation option for the Specialist. The Exchange proposes to offer the greater of the (1) Specialist Participation Entitlement; (2) ROT Priority or (3) DROT Priority, when the Specialist is the DROT, similar to BX.<sup>27</sup> Only the addition of the DROT priority is new, the remainder of this provision regarding this allocation exists today in the Phlx Rule. The Exchange is proposing to adopt the portion relating to the DROT Priority, similar to BX

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<sup>24</sup> See current rule text at Rule 1014(g)(vii)(B)(1)(c).

<sup>25</sup> See proposed Rule 1089(A)(1)(ii).

<sup>26</sup> See current rule text at Phlx Rule 1014(g)(vii)(B)(1)(c).

<sup>27</sup> See BX Rules at Chapter VI, Section 10(1)(C)(2)(ii)(1).

Rules. The Exchange believes that the addition of the DROT allocation is consistent with the Act because it serves to protect investors and the public interest by making clear when the DROT allocation would apply. Today, the rule is unclear as the priority of that allocation among Specialists.

As is the case today, the Specialist Participation Entitlement is applicable when the Specialist is at the same price with at least one other SQT or RSQT and the order is for number of contracts greater than 5.<sup>28</sup> As proposed, the Specialist is entitled to receive the greater of his Size Pro-Rata share, DROT Priority when the Specialist is the DROT, or the Enhanced Specialist Priority which is an enhanced participation of at least a certain percentage of the remainder of the order depending on the number of ROTs. The Specialist Participation Entitlement shall be 60% of remaining interest if there is one other ROT at that price. The Specialist Participation Entitlement shall be 40% of remaining interest if there are two ROTs at that price. Finally, the Specialist Participation Entitlement shall be 30% of remaining interest if there are more than two other ROTs at that price.<sup>29</sup>

Current Rule 1014(g)(vii)(B) states, “[q]uotations entered electronically by the specialist, an RSQT or an SQT that do not cause an order resting on the limit order book to become due for execution may be matched at any time by quotations entered electronically by the specialist and/or other SQTs and RSQTs, and by ROT limit orders and shall be deemed to be on parity, subject to the requirement that orders of controlled accounts must yield priority to customer orders as set forth in Rule 1014(g)(i)(A).” Rule

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<sup>28</sup> See Phlx Rule 1014(g)(vii)(B)(1)(a).

<sup>29</sup> See proposed Phlx Rule 1089(A)(1)(ii)(1)(a).



1014(g)(i)(A)(1) states, “The Enhanced Specialist Participation is a percentage of the Remainder of the Order to which the specialist is entitled.” Rule 1014(g)(ii) describes the Enhanced Specialist Participation as follows”

‘In equity option, index option and U.S. dollar-settled foreign currency options classes, when the registered specialist is on parity with a controlled account as defined in subparagraph (i) above, in accordance with Exchange Rules 119 and 120 and the number of contracts to be bought or sold is greater than five, the specialist is entitled to receive an enhanced participation of 30% of the Remainder of the Order (“Enhanced Specialist Participation”), except in the following circumstances: (1) where there is one controlled account on parity, the specialist is entitled to receive 60% of the Remainder of the Order; or (2) where there are two controlled accounts on parity, in which case, the specialist is entitled to receive 40% of the Remainder of the Order.’

The Exchange is not amending the percentages related to Specialist Enhanced Participation with this proposal nor the application therein.<sup>30</sup>

#### *Directed Orders*

Current Rule 1014(g)(viii) describes the manner in which Directed Orders are allocated. Directed Orders (as defined in Rule 1080(l)(i)(A)) that are executed electronically shall be automatically allocated as follows:

(A) First, to customer limit orders resting on the limit order book at the execution price. (B) Thereafter, contracts remaining in the Directed Order, if any, shall be allocated automatically as follows: (1) The Directed Specialist (where applicable), shall be allocated a number of contracts that is the greater of: (a) the proportion of the aggregate size at the NBBO associated with such Directed Specialist’s quote, SQT and RSQT quotes, and non-SQT ROT limit orders entered on the book at the disseminated price represented by the size of the Directed Specialist’s quote; (b) the Enhanced Specialist Participation as described in Rule 1014(g)(ii); or (c) 40% of the remaining contracts.

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<sup>30</sup> The language proposed herein tracks language similar to BX Rules at Chapter VI, Section 10(1)(C)(2)(ii). The Specialist is similar to a Lead Market Maker or “LMM” on BX.

A Specialist or ROT who receives a Directed Order is a “DROT” with respect to that Directed Order. Today, the Exchange allocates Directed Orders first to Customers orders. After all Customer orders have been fully executed, upon receipt of a Directed Order, provided the DROT’s bid/offer is at the better of the internal PBBO<sup>31</sup> excluding AON orders or the NBBO, the DROT receives a participation entitlement (DROT Priority). If the Specialist is the DROT, the Specialist receives the entitlement. The DROT is not entitled to receive a number of contracts that is greater than the displayed size at a given price point associated with such DROT. DROT participation entitlements are considered after the Opening Process. Pursuant to the DROT participation entitlement when the Specialist is the DROT, the DROT receives, with respect to a Directed Order, the greater of (1) the proportion of the aggregate size at the NBBO associated with such DROT’s quote, Specialist quote or order (if not the DROT), SQT and RSQT quotes or orders, and non-SQT ROT limit orders entered on the book at the disseminated price represented by the size of the DROT’s quote; (2) 40% of remaining interest; or (3) the Specialist Participation Entitlement in subsection 1089(A)(1)(ii)(1)(c) (if the DROT is also the Specialist).<sup>32</sup> The Exchange is not amending the DROT Priority, rather the Exchange is relocating the current rule text into a format similar to that of BX Rules at Chapter VI, Section 10(1)(C)(2)(iii). The Exchange proposes to make clear within the new rule text, when two different allocations apply, which allocation the Specialist is entitled to receive.

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<sup>31</sup> The PBBO is the Exchange’s best bid or offer.

<sup>32</sup> See proposed Phlx Rule 1089(A)(1)(iii). See similar rule text in Phlx Rule 1014(g)(viii)(A) and (B).

As is the case today, if there are multiple DROT quotes or orders at the same price which are at or improve on the NBBO when the Directed Order is received, the DROT participation entitlement applies only to the DROT quote or order which has the highest time priority at the first price executed upon receipt of the Directed Order which is equal to or better than the NBBO; the DROT quote or order that received the Directed Order may not receive any further allocation of the Directed Order, except as described in ROT Priority below. If rounding would result in an allocation of less than one contract, the DROT shall receive one contract. As is the case today, if the DROT Priority is not awarded at the time of receipt of the Directed Order, no DROT priority will apply and the order will be handled as though it were not a Directed Order for the remainder of the life of the order. The Exchange is not amending the DROT Priority, rather the Exchange is relocating the current rule text into a format similar to that of BX Rules at Chapter VI, Section 10(1)(C)(2)(iii). As is the case today, under no circumstances would the DROT quote receive an allocation of greater than 40% of an order at a price at which they receive a directed entitlement, unless it resulted from the allocation of remaining contracts.

Today, as noted above, Directed Orders are first allocated to Customers, then to the Directed Specialist as specified in Rule 1014(g)(viii)(A) and (B).<sup>33</sup> The Exchange

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<sup>33</sup> Phlx Rule 1014(g)(viii)(B) proposes that after Customer limit orders resting on the book are allocated, the contracts remaining in the Directed Order, if any, shall be allocated automatically as follows: (1) The Directed Specialist (where applicable), shall be allocated a number of contracts that is the greater of: (a) the proportion of the aggregate size at the NBBO associated with such Directed Specialist's quote, SQT and RSQT quotes, and non-SQT ROT limit orders entered on the book at the disseminated price represented by the size of the Directed Specialist's quote; (b) the Enhanced Specialist Participation as described in Rule 1014(g)(ii); or (c) 40% of the remaining contracts.

today applies a Size Pro-Rata execution algorithm to electronic orders, as described herein, other than Customers, including for Directed Orders. Currently, Rule 1014(g)(viii)(B)(1) and (2) describe the allocation algorithm utilizing a formula to explain the manner in which SQTs and RSQTs quoting at the disseminated price, and non-SQT ROTs that have placed limit orders on the limit order book via electronic interface at the Exchange's disseminated price shall be allocated contracts:

$$\frac{\text{Equal percentage based on the Number of SQTs, RSQTs and Non-SQT ROTs quoting or with limit orders at BBO (Component A)}}{\text{A}} + \frac{\text{Pro rata percentage based on size of SQT, RSQT and Non-SQT quotes and limit orders (Component B)}}{\text{B}} \times \text{Remaining Order Size}$$

The current rule at 1014(g)(viii)(B)(1) and (2) describes the weighting. The Exchange proposes to eliminate this formula and process for setting the final weighting and instead utilize the allocation rule text described herein, which the Exchange believes provides more clarity and consistency to the manner in which the allocation method is described for Directed Orders.

First, the Exchange proposes in Rule 1089(A)(1)(ii)(1)(c), rule text which permits a Directed Specialist to receive the DROT Priority if that allocation number were the greater number as between the Specialist Participation Entitlement, the ROT Priority and the DROT Priority. BX Rules permit such an allocation pursuant to BX Rules at Chapter VI, Section 10(1)(C)(2)(iii). As proposed in Rule 1089, only one allocation would be available to the Specialist. This proposal would permit the Directed Specialist to receive the DROT Priority if that would result in the greatest allocation. The Exchange is seeking in this rule change to provide clarity around which allocation applies if multiple allocations are available.

The Exchange proposes a new provision which would state, when a Directed Order is received and the DROT's quote is at or improves on the NBBO and the Specialist is at the same price level and is not the DROT, the Specialist participation entitlement set forth proposed Rule 1089(A)(1)(ii)(1) will not apply with respect to such Directed Order. BX's Rules at Chapter VI, Section 10(1)(C)(2)(ii)(1) provide for this restriction by prioritizing Specialists and DROTs at the same price level which are at or improve the NBBO. Today, the Exchange does not apply the Specialist Participation Entitlement in this scenario. Adopting the BX language will bring specificity to proposed Rule 1089 where these priorities intersect for a certain and uniform outcome.

Next, with respect to an order of 5 contracts or fewer that is directed to a DROT who is not the Specialist, quoting at better than the NBBO, the Exchange proposes that Rule 1089(A)(1)(ii)(1) shall not apply.<sup>34</sup> Today, the Exchange does not apply the Specialist Entitlement in this scenario. Adopting this new language which is similar to BX Rules at Chapter VI, Section 10(1)(C)(2)(ii)(2) will bring specificity to the rule with respect to the intersection of these priorities for a certain and uniform outcome. The Exchange believes that the addition of these new provisions will enhance competition by affording the Exchange the opportunity to compete for directed order flow.

The Exchange notes that current Rule 1014(g)(viii)(C) indicates that if the Directed Order is for a size that is greater than the Exchange's disseminated size, remaining contracts shall be allocated manually in accordance with Exchange Rule 1014(g)(v). The Exchange notes that this language is outdated and does not apply to the manner in which the Exchange allocates Directed Orders today. Today, all allocations

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<sup>34</sup> This is similar to BX Rules at Chapter VI, Section 10(C)(2)(ii)(2).

are done within the System; no allocation is handled manually. The Exchange is removing this provision to update its rules. The Exchange believes that removing outdated language is consistent with the Act and the protection of investors and the public interest because the rule text is confusing and outdated and removing it brings greater clarity to the rule.

The Exchange notes at proposed Rule 1089(A)(1)(vi) that only one participation entitlement, Specialist or DROT, may be applied on a given order or quote.<sup>35</sup> Although the Exchange applies no more than one participation entitlement today on a given quote or order, the Exchange is adopting this language to add further clarity to proposed Rule 1089. The Exchange believes the addition of this rule text is consistent with the Act because provide more specificity in the current rules protects investors and the public interest because the rules are clear.

#### *ROT Priority*

Current Rule 1014(g)(vii)(A) provides that “[I]f the specialist, an SQT, RSQT or a non-SQT ROT that has placed a limit order on the limit order book (“Phlx XL Participant”) is quoting alone at the disseminated price and their quote is not matched by another Phlx XL participant prior to execution, such Phlx XL Participant shall be entitled to receive a number of contracts up to the size associated with his/her quotation.”

The Exchange notes that it is not amending the manner in which ROTs are allocated. Proposed Rule 1089(A)(1)(iv) describes ROT Priority. After all Customer orders have been fully executed at a given price, provided the Customer order is an executable order, and Specialist Participation Entitlement or DROT Priority are applied,

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<sup>35</sup> This is similar to BX Rules at Chapter VI, Section 10(1)(C)(2)(v).

if applicable, remaining ROT interest shall have priority over all other orders at the same price. If there are two or more ROT quotes or orders for the same options series at the same price, those shall be executed based on the Size Pro-Rata execution algorithm. If there are contracts remaining, such contracts shall be allocated by randomly assigning all ROTs an order of allocation each trading day, and allocating orders, quotes and sweeps in accordance with the trading day's order assignment, provided the ROT is at the price at which the order, quote or sweep is being traded.<sup>36</sup>

The Exchange's amendment to indicate the manner in which remaining contracts are allocated among market participants is new. This language specifies that for ROTs, remaining contracts are allocated among equally priced ROTs, by random assignment of ROTs, each trading day in accordance with the trading day's order assignment, provided the ROT is at the price at which the order is being traded. With respect to off-floor broker-dealers, residual contracts after Size Pro-Rata allocation are allocated in time priority, provided the off-floor broker-dealers are at the price at which the order is being traded. The Exchange believes that this new text that addresses allocation of remaining contracts, which is being applied uniformly for all ROTs, and separately for all off-floor broker-dealers, is consistent with the Exchange Act because it provides for the equitable allocation of contracts among the Exchange's market participants of similar priority. With respect to off-floor broker-dealers, the method is consistent with the Act because it relies simply on time priority, an accepted method of allocation utilized by many options exchange to prioritize orders.

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<sup>36</sup> This is similar to Market Maker Priority on BX at Chapter VI, Section 10(C)(2)(iv).

Specifically, with respect to the new text regarding the allocation method for remaining contracts for ROTs, this random assignment is basically a round robin approach to the allocation. The Exchange believes that this method results in a fair and equitable allocation of contracts to these market participants because each trading day the Exchange creates a new order of assignment to allocate ROTs and that order provides an independent method to assign evenly among ROTs. Also, each trading day that assignment changes so that no one ROT would have the ability to receive a greater allocation than another ROT. The Exchange believes that its assignment method is not subject to gaming since it is random and therefore complies with the Act because it is aimed at the protection of investors and the public interest. Also, this rule change will provide market participants with transparency as to the number of contracts that they are entitled to receive as the result of the allocation of remaining contracts.

*All Other Remaining Interest*

Current Rule 1014(g)(vii)(B)(1)(d) provides, with respect to Off-Floor Broker-Dealer Orders:

if any contracts remain to be allocated after the Phlx XL Participants have received their respective allocations, off-floor broker-dealers (as defined in Rule 1080(b)(i)(C)) that have placed limit orders on the limit order book which represent the Exchange's disseminated price shall be entitled to receive a number of contracts that is the proportion of the aggregate size associated with off-floor broker-dealer limit orders on the limit order book at the disseminated price represented by the size of the limit order they have placed on the limit order book. Such off-floor broker-dealers shall not be entitled to receive a number of contracts that is greater than the size that is associated with each such limit order.

Proposed Rule 1089(A)(1)(v) provides, with respect to all other remaining interest, if there are contracts remaining after all ROT interest has been fully executed,



such contracts shall be executed based on the size Pro-Rata execution algorithm.<sup>37</sup> In the event that there are remaining contracts to be allocated after allocating based on the size Pro-Rata algorithm, such remaining contracts will be allocated in time priority, one at a time, provided the off-floor broker-dealers, which includes orders of all market participants other than Customers, ROTs and Specialists, are at the price at which the order is being traded. This practice of allocation is not being amended, rather the rule text is being amended to make it clear.

*Other Sections*

Rule 1014(g)(vii)(B)(1)(e) provides that no Phlx XL Participant shall be entitled to receive a number of contracts that is greater than the size that is associated with their quotation or limit order. This concept is expressed within proposed Rule 1089 throughout the proposed rule text rather than in a lone standing rule. The Exchange believes that this additional language is no longer necessary because this concept is embedded in the new proposed language.

Rule 1014(g)(vii)(2) entitled “*No Split-Price Executions*,” provides [i]f the size associated with a market order or an electronic quotation to be executed is received for a greater number of contracts than the Exchange’s disseminated size, the portion of such an order or quotation executed automatically at the Exchange’s disseminated size shall be allocated automatically in accordance with Rule 1014(g)(vii). Contracts remaining in such an order shall be represented by the specialist and handled in accordance with Exchange Rules.” The Exchange notes that this language is obsolete and not in effect

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<sup>37</sup> This is the manner in which the Exchange allocates remaining interest today pursuant to Rule 1014(g)(vii)(B)(1)(d). Also, the rule text is similar to of BX Rules at Chapter VI, Section 10(1)(C)(2)(iv).

today. The Exchange does not permit any manual handling of orders. The Exchange believes that it is consistent with the Act and the protection of investors and the public interest to eliminate this obsolete language to provide clarity to members as to the manner in which the System allocates trades.

Current Rule 1014(g)(vii)(B)(3) provides that notwithstanding the first sentence of Rule 1014(g)(i), neither Rule 119(a)-(d) and (f), nor Rule 120 (insofar as it incorporates those provisions by reference) shall apply to the allocation of automatically executed trades. The Exchange notes that Rules and 120 are being disconnected from the electronic allocation model. The Exchange is proposing to create a new Rule for electronic allocation, as compared to floor allocation. Proposed Phlx Rule 1089 will not rely on concepts of controlled accounts or parity and therefore the application to Rules 119 and 120 is unnecessary. The proposed rule is structured to indicate the manner in which market participants will be allocated in reference to each other in a more streamlined manner. The Exchange believes that deleting this rule text is consistent with the Act, specifically the protection of investors and the public interest because this rule text does not serve to describe in a clear manner the method in which the Exchange allocated electronic transactions.

#### Cross-References

The Exchange is amending the references to Rule 1014 in Rule 1082, Commentary .02 and .03 to update the references to the new proposed rule.

#### Behavior Changes with this Proposal

With this proposal, there are three new provisions which result in behavior which does not exist today on Phlx.

First, the Exchange proposes rule text in proposed Rule 1089(A)(1)(ii)(1) which would permit a Specialist to receive the DROT Priority if that allocation number were the greater number as between the Specialist Participation Entitlement, the ROT Priority and the DROT Priority. Only one allocation would be available to the Specialist, as is the case today. This proposal would permit the Specialist to receive the DROT Priority if that were the greater allocation number. The Exchange's proposal to add rules similar to BX which address the intersection between the DROT and Specialist is consistent with the Act because the natural conflicts as between the entitlements is addressed in more detail and consistent with the manner in which BX operates today. The Exchange will permit a Specialist to receive the higher of all entitlements pursuant to proposed Rule 1089. The new language at proposed Rule 1089(A)(1)(ii)(1)(c) recognizes that a Specialist could be the DROT and receive a higher allocation.

Second, the Exchange proposes that when a Directed Order is received and the DROT's quote is at or improves on the NBBO and the Specialist is at the same price level and is not the DROT, the Specialist participation entitlement set forth proposed Rule 1089(A)(1)(ii)(1) will not apply with respect to such Directed Order.

Third, with respect to an order of 5 contracts or fewer that is directed to a DROT who is not the Specialist, quoting at or better than the NBBO, proposed Rule 1089(A)(1)(ii)(2) shall not apply. The Exchange's proposed text at proposed Rule 1089(A)(2) makes clear that if the order of 5 contracts or fewer were directed to a DROT who is not the Specialist, quoting at or better than the NBBO, the provision related to the allocation to the Specialist at 1089(A)(2) would not apply. The Exchange believes that conforming the intersection between Specialist and DROT entitlements to BX rules will

not only offer Exchange members the same opportunities for allocation as BX Participants, but will also bring certainty to the Exchange' allocation rules when multiple priorities may apply. Also with respect to the 5 contracts or fewer the Exchange is adding more specificity to proposed Rule at 1080(A)(1)(ii)(2) as the Exchange has noted within this proposal.

Below are some examples of Specialist allocation pursuant to the Size Pro-Rata model.

***Example Number 1:***

ABBO = 1.00 – 1.10

PBBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

Specialist: 1.00 bid (10 contracts) – 1.10 offer (15 contracts)

Customer A: 5 contracts offered at 1.10

Firm: 5 contracts offered at 1.10

ROT 1: 1.00 bid (10 contracts) – 1.10 offer (20 contracts)

ROT 2: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)

Customer B: 2 contracts offered at 1.10

Incoming Order to pay 1.10 for 40 contracts

Allocated as follows:

Size Pro-Rata results in Customer A trading 5 contracts, Customer B trading 2 contracts, Specialist trading 11 contracts (15/45\*33 remaining), ROT1 trading 14 contracts (20/45\*33), ROT2 trading 7 contracts (10/45\*33), and then Specialist receiving an additional 1 lot based on random assignment.

Specialist Participation Entitlement would result in Customer A trading 5 contracts, Customer B trading 2 contracts, and Specialist trading 40% of remaining 33 contracts= 13 (13.2 rounded down); then Size Pro-Rata for remaining with ROT1 trading 13 contracts (20/30\*20) and ROT2 trading 6 contracts (10/30\*20) and Specialist trading an additional 1 lot based on random assignment.

The Specialist Participation Entitlement would prevail in this example, pursuant to proposed Rule 1089(A)(1)(ii)(1), because the Specialist Participation Enhancement receives greater allocation.

***Example Number 2:***

ABBO = 1.00 – 1.10

PBBO = 1.00 – 1.10 comprised of the following in order of receipt

Orders/Quotes entered into Trading System in the following order of receipt:

ROT 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)

Customer A: 10 contracts offered at 1.10

Firm: 15 offered at 1.10

Specialist: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)

ROT 2: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)

Customer B: 10 contracts offered at 1.10

Incoming Order to pay 1.10 for 40 contracts

Allocated as follows:

Size Pro-Rata results in Customer A trading 10 contracts, Customer B trading 10 contracts, Specialist trading 6 contracts (10/30\*20 remaining rounded down), ROT1 trading 6 contracts (10/30\*20), ROT2 trading 6 contracts (10/30\*20), and then ROT1 and Specialist each receiving an additional 1 lot based on random assignment.

Specialist Participation Entitlement would result in Customer A trading 10 contracts, Customer B trading 10 contracts, and Specialist trading 40% of remaining 20 contracts = 8; then normal pro rata resumes with ROT1 and ROT2 each being allocated 6 contracts.

Pursuant to proposed Rule 1089(A)(1)(ii)(1), the Specialist Participation Entitlement would prevail in this example because the Specialist Participation Entitlement receives greater allocation.

***Example Number 3:***

ABBO = 1.00 – 1.10

PBBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

ROT 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)

Firm: 25 offered at 1.10

Specialist: 1.00 bid (10 contracts) – 1.10 offer (20 contracts)

ROT 2: 1.00 bid (5 contracts) – 1.10 offer (10 contracts)

ROT 3 1.00 bid (10 contracts) – 1.10 offer (20 contracts)

Customer B: 2 contracts offered at 1.10

Incoming Order to pay 1.10 for 40 contracts

Allocated as follows:

Size Pro-Rata results in Customer B trading 2 contracts, ROT1 trading 6 contracts (10/60\*38), Specialist trading 12 (20/60\*38), ROT2 trading 6 contracts (10/60\*38), and ROT3 trading 12 contracts (20/60\*38) and then ROT1 and Specialist each trading an additional 1 contract by random assignment.

Specialist Participation Entitlement would result in Customer B trading 2 contracts and Specialist trading 30% of remaining 38 contracts = 11 (11.4 rounded down); then normal pro rata resumes and ROT1 trades 6 contracts (10/40\*27), ROT2 trades 6 (10/40\*27), and ROT3 trades 13 contracts (20/40\*27) and ROT1 and Specialist each trade an additional 1 lot by random assignment.

Size Pro-Rata allocation would prevail because the Specialist Participation Entitlement receives greater allocation pursuant to proposed Rule 1089(A)(1)(ii)(1)

Below are some examples of DROT Participation Entitlement under Size Pro-Rata Algorithm. Examples 1 through 3 below illustrate the manner in which a DROT will be allocated pursuant to the Size Pro-Rata model.

***Example Number 1:***

Assume a Specialist is assigned and the DROT is **not** the Specialist.

ABBO = 1.00 – 1.10

PBBO = 1.00 – 1.10 comprised of the following in order of receipt:

Specialist: 1.00 (10) – 1.10 (15)

Customer A: 5 offered at 1.10

Firm: 5 offered at 1.10

DROT: 1.00 (10) – 1.10 (20)

ROT1: 1.00 (10) – 1.10 (10)

Customer B: 2 offered at 1.10

Incoming Directed Order to pay 1.10 for 40 contracts.

Determination of Allocation:

Size Pro-Rata would result in Customer A trading 5, Customer B trading 2, Specialist trading 11 (15/45\*33remaining), DROT trading 14 (20/45\*33), ROT1 trading

7 ( $10/45*33$ ), and then Specialist receiving the residual 1 lot based on random assignment.

DROT Priority would result in Customer A trading 5, Customer B trading 2, and DROT trading 40% of remaining 33 = 13 (13.2 rounded down); then normal Size Pro-Rata for remaining with the Specialist trading 12 ( $15/25*20$ ) and ROT1 trading 8 ( $10/25*20$ ).

The Specialist Participation Entitlement would not be calculated since the Specialist is not the DROT.

In this example, the Size Pro-Rata allocation would prevail since the DROT would receive the greater allocation this way.

***Example Number 2:***

Assume that no Specialist is present.

ABBO = 1.00 – 1.10

PBBO = 1.00 – 1.10 comprised of the following in order of receipt:

DROT: 1.00 (10) – 1.10 (15)  
 Customer A: 5 offered at 1.10  
 Firm: 5 offered at 1.10  
 ROT1: 1.00 (10) – 1.10 (20)  
 ROT2: 1.00 (10) – 1.10 (10)  
 Customer B: 2 offered at 1.10

Incoming Directed Order to pay 1.10 for 40 contracts.

Determination of Allocation:

Size Pro-Rata would result in Customer A trading 5, Customer B trading 2, DROT trading 11 ( $15/45*33$  remaining), ROT1 trading 14 ( $20/45*33$ ), ROT2 trading 7 ( $10/45*33$ ), and the DROT receiving the residual 1 lot based on random assignment.

DROT Priority would result in Customer A trading 5, Customer B trading 2, and DROT trading 40% of remaining 33 = 13 (13.2 rounded down); then normal Size Pro-Rata for remaining with ROT1 trading 13 ( $20/30*20$ ) and ROT2 trading 6 ( $10/30*20$ ), and the DROT receiving the residual 1 lot based on random assignment.

The Specialist Participation Entitlement would not be calculated since the Specialist is not the DROT.

In this example, the DROT Priority would prevail since the DROT Priority would receive the greater allocation this way.

**Example Number 3:**

Assume that the DROT is **also** the Specialist.

ABBO = 1.00 – 1.10

PBBO = 1.00 – 1.10 comprised of the following in order of receipt:

DROT/Specialist: 1.00 (10) – 1.10 (15)

Customer A: 5 offered at 1.10

Firm: 5 offered at 1.10

ROT1: 1.00 (10) – 1.10 (30)

Customer B: 2 offered at 1.10

Incoming Directed Order to pay 1.10 for 40 contracts.

Determination of Allocation:

Size Pro-Rata would result in Customer A trading 5, Customer B trading 2, DROT/Specialist trading 11 ( $15/45 \times 33$  remaining), ROT1 trading 22 ( $30/45 \times 33$ ).

DROT Priority would result in Customer A trading 5, Customer B trading 2, and DROT/Specialist trading 40% of remaining  $33 = 13$  (13.2 rounded down); then Size Pro-Rata for remaining with ROT1 trading full size of 20.

The Specialist Participation Entitlement would result in Customer A trading 5, Customer B trading 2, and DROT/Specialist entitled to 60% of remaining  $33 = 19$  (19.8 rounded down) but capped at his size of 15 thus trading 15; then normal Size Pro-Rata for remaining with ROT1 trading 18.

In this example, the Specialist Participation Entitlement would prevail since the DROT is the Specialist and would receive a greater allocation this way.

Examples with Rounding and Remainders

***Example Number 1:***

Presume an order of 200 contracts is being allocated in the Exchange's Order Book. Allocation will first occur with Customer orders at the best price filled in time priority, since Customers always have priority on the Exchange. Presume there are 63 contracts remaining after Customer orders are filled. Assume no Specialist is present thus, ROTs would be allocated next pursuant to Rule 1089 in Size Pro-Rata fashion. Presume 5 ROTs are at the best price and the allocation of the remaining 63 contracts, after Customer orders have been satisfied, is as follows:

ROT A  $1.10(30) \times 1.20(30) \text{ --- } 25.2$  rounded down to 25 contracts



ROT B  $1.10(15) \times 1.20(15) \text{ --- } 12.6$  rounded down to 12 contracts

ROT C  $1.10(10) \times 1.20(10) \text{ --- } 8.4$  rounded down to 8 contracts

ROT D  $1.10(10) \times 1.20(10) \text{ --- } 8.4$  rounded down to 8 contracts

ROT E  $1.10(10) \times 1.20(10) \text{ --- } 8.4$  rounded down to 8 contracts

After this Size Pro-Rata allocation, 2 contracts remain to be allocated. Presume for this trading day these ROTs are assigned the following order of assignment: first is ROT A, second is ROT B, third is ROT C, fourth is ROT D and fifth is ROT E. The 2 remaining contracts would be allocated as follows:

ROT A  $1.10(30) \times 1.20(30) \text{ --- } 1$  contract

ROT B  $1.10(15) \times 1.20(15) \text{ --- } 1$  contract

ROT C  $1.10(10) \times 1.20(10) \text{ --- } 0$

ROT D  $1.10(10) \times 1.20(10) \text{ --- } 0$

ROT E  $1.10(10) \times 1.20(10) \text{ --- } 0$

The next order which results in contracts remaining after the Size Pro-Rata allocation to ROTs will have such remaining contracts allocated one at a time beginning with ROT C since he was next in line based on that trading day's order of assignment, provided ROT C is at the best price with remaining interest.

***Example Number 2:***

Presume an order of 200 contracts is being allocated in the Exchange's Order Book. Presume all Customer orders and ROT interest that was at the best price have been filled and there remains 9 contracts to be executed.

Off-floor broker-dealers would be allocated next pursuant to Rule 1089 in a Size Pro-Rata fashion. Presume 3 off-floor broker-dealers are at the best price and their interest had arrived in the following order. The allocation of the remaining 9 contracts is as follows:

Off-floor broker-dealer C  $1.10(5) \times 1.20(5) \text{ --- } 4.09$  contracts rounded down to 4

Off-floor broker-dealer B  $1.10(3) \times 1.20(3) \text{ --- } 2.45$  contracts rounded down to 2

Off-floor broker-dealer A  $1.10(3) \times 1.20(3) \text{ --- } 2.45$  contracts rounded down to 2

After this Size Pro-Rata allocation, there remains one contract to be allocated. This residual contract will be allocated in time priority as follows:

Off-floor broker-dealer C 1.10 (5) x 1.20 (5) – 1 contract

Off-floor broker-dealer B 1.10 (3) x 1.20(3) – zero

Off-floor broker-dealer A 1.10 (3) x 1.20(3) -- zero

b. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>38</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>39</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, by conforming the format of the allocation to that of BX for purposes of comparing the allocation methods and also bringing clarity the electronic allocation rule. Also, the adoption of new rule text will allow the Exchange to effectively compete against other markets. The Exchange has incorporated this rationale into the Purpose Section in this form.

4. 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 does not believe the proposed change will cause any unnecessary burden on inter-market competition because all Exchange members may apply to be either Specialists or ROTs and, presuming all requirements are met, would be entitled to

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<sup>38</sup> 15 U.S.C. 78f(b).

<sup>39</sup> 15 U.S.C. 78f(b)(5).

receive participation entitlements provided they direct orders and those orders are executed by those DROTs.

With respect to rounding, all rounding is down to the nearest integer. The Exchange does not believe that the proposal to round all remaining contracts down to the nearest integer imposes an undue burden on competition because the Exchange will uniformly round in this matter.

With respect to allocating remaining contracts, the Exchange does not believe that the proposal to allocate remaining contracts for ROTs by random assignment creates an undue burden on competition because the method, which is basically round robin, results in a fair and equitable allocation of shares of these market participants. The Exchange does not believe that allocating remaining contracts to off-floor broker-dealers in time priority creates an undue burden on competition because the method will be applied uniformly among these participants.

Permitting Specialists to receive an allocation over ROTs when the Specialist is the DROT does not create an undue burden on competition because today Phlx permits the Specialist to be ahead of ROTs generally within its allocation method. Specialists have higher quoting obligations as compared to ROTs (90% versus 60% of the series in which assigned).<sup>40</sup>

The Exchange's proposal to add new provisions relating to Directed Orders and Specialists does not create an undue burden on competition because BX already has similar rules in place and the new rules bring certainty to the Exchange' allocation rules when multiple priorities may apply.

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<sup>40</sup>

Id.

5. 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.

6. Extension of Time Period for Commission Action

The Exchange does not consent to an extension of the time period for Commission action.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

1. Notice of Proposed Rule Change for publication in the Federal Register.
5. Text of the proposed rule change.

**EXHIBIT 1**

SECURITIES AND EXCHANGE COMMISSION  
(Release No. \_\_\_\_\_ ; File No. SR-Phlx-2017-45)

December \_\_, 2017

Self-Regulatory Organizations; Nasdaq PHLX LLC; Notice of Filing of Proposed Rule Change Relating to the Allocation of Automatically Executed Trades

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 December 7, 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 reserve Rule 1014(g)(vii) and (viii), which describes the allocation of automatically executed trades, and adopt a new Rule 1089 and title that rule “Electronic Execution Priority and Processing in the System.”

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.

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

<sup>2</sup> 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 Exchange proposes to remove the current rule text describing the allocation of automatically executed trades from Phlx Rule 1014(g)(vii) and (viii) and, in its place, adopt new Phlx Rule 1089 titled "Electronic Execution Priority and Processing in the System" to describe the manner in which the Exchange will process, prioritize and allocate transactions in the order entry system ("System").<sup>3</sup> In adopting Rule 1089, the Exchange proposes to model the rule on Nasdaq BX, Inc.'s ("BX") "Book Processing" rule at Chapter VI, Section 10.

The current rule text in Rule 1014(g)(vii) provides that after public customer market and marketable limit orders have been executed, trades automatically executed in such options shall be allocated automatically in the following manner:

(A) If the specialist, an SQT, RSQT or a non-SQT ROT that has placed a limit order on the limit order book ("Phlx XL Participant") is quoting alone at the disseminated price and their quote is not matched by another Phlx XL participant prior to execution, such Phlx XL Participant shall be

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<sup>3</sup> For purposes of this rule, the term "System" shall mean the automated system for order execution and trade reporting owned and operated by the Exchange.

entitled to receive a number of contracts up to the size associated with his/her quotation.

(B) *Parity*. Quotations entered electronically by the specialist, an RSQT or an SQT that do not cause an order resting on the limit order book to become due for execution may be matched at any time by quotations entered electronically by the specialist and/or other SQTs and RSQTs, and by ROT limit orders and shall be deemed to be on parity, subject to the requirement that orders of controlled accounts must yield priority to customer orders as set forth in Rule 1014(g)(i)(A).

Proposed Rule 1089(A) states that the Exchange will apply a Size Pro-Rata execution algorithm, as is the case today, to electronic orders/quotes to each level of priority separately, other than Customers.<sup>4</sup> Customers will retain priority over other market participants, as is in the case today. Proposed Rule 1089(A)(1)(i) describes that priority.<sup>5</sup> For purposes of this rule a Customer shall be defined as a person or entity that is not a broker or dealer in securities.

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<sup>4</sup> For example, Size Pro-Rata allocation is applied to market maker priority and separately for all other remaining interest. On Phlx an “Options Market Maker” includes Specialists and Registered Options Traders (“ROT”) (which includes Streaming Quote Traders (“SQT”) and Remote Streaming Quote Traders (“RSQT”)) and floor market makers. A Specialist is an Exchange member who is registered as an options specialist. See Phlx Rule 1020(a). A ROT is a regular member or a foreign currency options participant of the Exchange who has received permission from the Exchange to trade in options for his own account. 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. 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. A floor market maker is known as a non-SQT ROT in Rule 1014(b)(ii)(C). A non-SQT ROT is an ROT who is neither an SQT nor an RSQT.

<sup>5</sup> Customer Priority shall mean that the highest bid and lowest offer shall have priority except that Customer orders shall have priority over non-Customer interest at the same price, provided the Customer order is an executable order. 2

The priority for market makers in current Rule 1014(g)(vii)(A) is described differently in proposed Rule 1089, however the priority treatment remains unchanged from how the system functions today. The new rule describes how the various market makers will be specifically allocated.<sup>6</sup> The rule lays out the order in which the trading system will allocate trades to the various type of participants. A Specialist shall receive the greater of:

(a) When the Specialist is at the same price with SQT, RSQT or non-SQT ROT (collectively “ROTs”) and the number of contracts is greater than 5, the Specialist is entitled to receive an enhanced participation of at least 30% of the remainder of the order (“Specialist Participation Entitlement”);  
or

(i) 60% of remaining interest if there is one other ROT at that price;

(ii) 40% of remaining interest if there are two other ROTs at that price;

(iii) 30% of remaining interest if there are more than two other ROTs at that price; or

(b) the Specialist’s size pro-rata share under (A)(1)(iv) (“ROT Priority”);  
or

(c) the Directed ROT (“DROT”) participation entitlement, if any, set forth in subsection (A)(1)(iii) below (if the order is a Directed Order and the Specialist is also the DROT) (“DROT Priority”).

Finally, the concept of parity is removed from the new Rule as a separate concept.

The Exchange believes that it is not necessary to discuss allocation in terms of parity.

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If there are two or more Customer orders for the same options series at the same price, priority shall be afforded to such Customer orders in the sequence in which they are received by the System.

<sup>6</sup> After all Customer orders have been fully executed, upon receipt of an order, provided the Specialist’s bid/offer is at or improves on the Exchange’s disseminated price, the Specialist will be afforded a participation entitlement. The Specialist shall not be entitled to receive a number of contracts that is greater than the displayed size associated with such Specialist.



The outline of the new rule describes the manner in which the trading system will allocate orders to various market participants based on a Size Pro-Rata model. The Exchange notes that the concept of priority is detailed within each section when describing similarly situated market participants. The Exchange believes that removing the rule text related to parity from the proposed rule is consistent with the Act because while the Exchange is not specifically describing parity within the proposed rule, the Exchange will allocate based on parity as described in more detail within the specific allocations provided for within the proposed rule.

Current Rule 1014(g)(vii)(A)(1)(a) contains the following language for orders of 5 contracts or fewer:

orders for 5 contracts or fewer shall be allocated first to the specialist, provided, however, that on a quarterly basis, the Exchange will evaluate what percentage of the volume executed on the Exchange is comprised of orders for 5 contracts or fewer allocated to specialists, and will reduce the size of the orders included in this provision if such percentage is over 25%. In order to be entitled to receive the 5 contract or fewer order preference set forth in this subparagraph (B)(1)(a), the specialist must be quoting at the Exchange's disseminated price, and shall not be entitled to receive a number of contracts that is greater than the size that is associated with its quote. If the specialist is not quoting at the Exchange's disseminated price at the time of execution, orders for 5 contracts or fewer shall be allocated to Phlx XL Participants on parity as set forth in paragraph (b) below.

The provision for contracts of 5 lots or fewer is carried over into proposed Rule 1089(A)(1)(ii)(2), however the new Rule 1089(A)(1)(ii)(1)(c) provides that if the order, including orders of 5 lots or fewer, is a Directed Order,<sup>7</sup> the Directed Order allocation

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<sup>7</sup> A Directed Order is defined in 1080(1)(i)(A) as any order (other than a stop or stop-limit order as defined in Rule 1066) to buy or sell which has been directed to a particular specialist, RSQT, or SQT by an Order Flow Provider or "OFP." If the Exchange's disseminated best bid or offer is at the NBBO when the Directed Order is received, the Directed Order is automatically executed on Phlx XL and allocated to the orders and quotes represented in the Exchange's quotation. A

would apply. This additional clarity will make clear when the Directed Order allocation would be allocated. The language of Rule 1014(g)(vii)(A)(1)(a) is similar to proposed Rule 1089(A)(1)(ii)(2), except that the rule now states, in order to be entitled to receive the 5 contract or fewer order preference set forth in this sub-paragraph (A)(1)(ii)(2), the Specialist *must have an quote/order*<sup>8</sup> at the Exchange's disseminated price with no other interest present which has a higher priority, and shall not be entitled to receive a number of contracts that is greater than the size that is associated with its quote. Also, the rule is proposed to state, if the Specialist is not quoting at the Exchange's disseminated *best*<sup>9</sup> price *with no other interest present which has a higher priority at the time of execution, a Specialist is not entitled to priority with respect to the 5 contracts or fewer, however the Specialist is eligible to receive such contracts pursuant to 1089(A)(i)(iv), thereafter orders will be allocated pursuant to 1089(A)(1)(iv).*<sup>10</sup> This sub-paragraph (A)(1)(ii)(2) shall only apply after the opening and shall not apply to auctions. The Exchange proposes to add even more specificity to proposed Rule 1089(A)(1)(ii)(2) to note that if a

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Directed Specialist, SQT, or RSQT will receive a participation allocation pursuant to Exchange Rule 1014(g)(viii) if the Directed Specialist, SQT, or RSQT was quoting at the best price on the Exchange which is at or better than the NBBO at the time that the Directed Order was received pursuant to Phlx Rule 1080(I)(ii).

<sup>8</sup> Today this states must be quoting. The Exchange believes it is more accurate to state have an quote or order as a Specialist may also submit an order.

<sup>9</sup> The addition of the word "best" is a more accurate statement because the interest must be at the best price to be executed.

<sup>10</sup> The current sentence states, "If the specialist is not quoting at the Exchange's disseminated price at the time of execution, orders for 5 contracts or fewer shall be allocated to Phlx XL Participants on parity as set forth in paragraph (b) below." The new sentence proposes additional specificity, as described herein, to reflect that the the Specialist must be at the Exchange's disseminated best price to be entitled to priority with respect to the 5 contracts or fewer, otherwise allocation shall be among other participants at the same price.

Customer is resting at the Exchange's disseminated best price at the time of execution, a Specialist is not entitled to priority with respect to the 5 contracts or fewer, as is the case today. The Exchange believes that this proposed change is consistent with the Act because the Specialist will not be entitled to priority with respect to the 5 contracts or fewer because there is interest of higher priority resting at the Exchange's disseminated best price or because the Specialist is not quoting at the Exchange's disseminated best price. In these situations, the Specialist will receive ROT priority, and be treated on par with other market makers, pursuant to Rule 1089(A)(1)(iv). The Exchange's proposed rule would not allow for two separate priority allocations. The Exchange notes in proposed Rule 1089(A)(1)(ii)(2) that the provision for contracts of 5 lots or fewer applies only after the Opening Process<sup>11</sup> and does not apply to auctions. This clarifying language is added to the proposed rule to provide more detail as to the manner in which the provision for contracts of 5 lots or fewer is applied.<sup>12</sup> The Exchange believes that the proposed new rule text is consistent with the Act because the new language proposes to make clear when the Specialist is entitled to the 5 lot allocation with more specificity

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<sup>11</sup> The Opening Process is described at Phlx Rule 1017, entitled "Openings in Options."

<sup>12</sup> For example, the Exchange's PIXL auction and the Opening Process would not be subject to proposed Rule 1089(A)(1)(ii)(1). PIXL<sup>SM</sup> is the Exchange's price improvement mechanism known as Price Improvement XL or PIXL. A member may electronically submit for execution an order it represents as agent on behalf of a public customer, broker-dealer, or any other entity ("PIXL Order") against principal interest or against any other order (except as provided in Rule 1080(n)(i)(E)) it represents as agent ("Initiating Order"), provided it submits the PIXL order for electronic execution into the PIXL Auction pursuant to Rule 1080. See Phlx Rule 1080(n). The Opening Process is explained in Phlx Rule 1017.

than is in the rule today. The proposed rule text protects investors and the public interest by adding clarifying language to the rule text.

The Exchange proposes to memorialize the manner in which rounding will be handled in proposed Rule 1089(A)(1)(ii). If rounding would result in an allocation of less than one contract, a Specialist will receive one contract. With respect to all other rounding, all rounding is down to the nearest integer. The Exchange believes that rounding down uniformly is consistent with the Exchange Act because it provides for the equitable allocation of contracts among the Exchange's market participants. Also, this rule change will provide market participants will transparency as to the number of contracts that they are entitled to receive as the result of rounding. Rule 1014(g)(vii) currently does not address the manner in which the System handles rounding. The Exchange proposes to memorialize in proposed Rule 1089(A) the following language to clarify the manner in which the Exchange handles rounding today, "If the result is not a whole number, it will be rounded down to the nearest whole number."<sup>13</sup> The Exchange believes that clearly indicating the manner in which rounding occurs within the order book will bring clarity to the allocation process. The Exchange notes that rounding will be uniformly applied to all market participants.

Current Rule 1014 (g)(vii)(A)(1)(b) provides that:

Respecting orders for greater than 5 contracts (regardless of whether the specialist is quoting at the Exchange's disseminated price), or orders for 5 contracts or fewer when the specialist is not quoting at the Exchange's disseminated price, inbound electronic orders shall be allocated pursuant to the following allocation algorithm:

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<sup>13</sup> Phlx and BX round differently. BX's rounds up or down to the nearest integer. See BX Rules at Chapter VI, Section 10 (1)(C)(1)(b)(1).

$$\frac{\begin{array}{l} \text{Equal percentage based on the} \\ \text{number of Phlx XL} \\ \text{Participants quoting or with} \\ \text{limit orders at BBO} \\ \text{(Component A)} \end{array} + \begin{array}{l} \text{Pro rata percentage based} \\ \text{on size of Phlx XL} \\ \text{participant quotes/limit} \\ \text{orders (Component B)} \end{array}}{2} \times \text{Incoming Order Size}$$

Where:

**Component A:** The percentage to be used for Component A shall be an equal percentage, derived by dividing 100 by the number of Phlx XL participants quoting at the BBO.

**Component B: Size Pro Rata Allocation.** The percentage to be used for Component B of the allocation algorithm formula is that percentage that the size of each Phlx XL Participant's quote at the best price represents relative to the total number of contracts in the disseminated quote.

**Final Weighting:** The final weighting formula for equity options, which shall be determined by a three-member special committee of the Board of Directors, chaired by the President of the Exchange, and two Directors (the "Special Committee" ), and apply uniformly across all equity options, shall be a weighted average of the percentages derived for Components A and B multiplied by the size of the incoming order. Initially, the weighting of components A and B shall be equal, represented mathematically by the formula:  $(\text{Component A Percentage} + \text{Component B Percentage})/2$  \* incoming order size.

The final weighting formula for index options and options on Exchange Traded Fund Shares (as defined in Rule 1000(b)(42.)) shall be established by the Special Committee. The final weighting formula for options on U.S. dollar-settled foreign currency options shall be established by a three-member special committee of the Board of Directors, chaired by the President of the Exchange, and two Governors. The final weighting formula may vary by product. Changes made to the percentage weightings of Components A and B shall be announced to the membership on the Exchange's website at least one day before implementation of the change.

With respect to this formula, the Exchange notes that the Exchange is replacing this formula with a more streamlined analysis of the manner in which orders will be allocated in the trading system. At this time, the Exchange proposes to eliminate the formula, the weighting process and the ability to determine values for the weighting and

simply state that it will apply a Size Pro-Rata execution algorithm to electronic orders.<sup>14</sup> This is the manner in which Phlx allocates today. The Exchange is adopting rule text to memorialize the manner in which the allocation operates today. The Exchange proposes the following rule text to describe the Size-Pro Rata execution algorithm, “The Exchange will apply a Size Pro-Rata execution algorithm to electronic orders. The System shall execute trading interest within the System in price priority, meaning it will execute all trading interest at the best price level within the System before executing trading interest at the next best price.”<sup>15</sup>

The Exchange proposes to clearly define the priority overlays that are currently applied today. Today, the Exchange allocates contracts utilizing a Customer Priority Size Pro-Rata allocation model. First, Customer contracts are allocated in Price-Time priority<sup>16</sup>. Thereafter, the Exchange allocates interest to electronic orders/quotes of Specialists utilizing a Size Pro-Rata allocation model.<sup>17</sup> Lastly, the Exchange allocates interest to off-floor broker dealer orders<sup>18</sup> utilizing a Size Pro-Rata allocation model,

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<sup>14</sup> Phlx offers both an electronic and floor model for the execution of options transactions. Floor transactions are subject to Phlx Rule 1014(g)(v).

<sup>15</sup> See proposed Phlx Rule 1089(A). This rule text is similar to BX Rules at Chapter VI, Section 10(1)(A) and (B) with respect to BX’s Price/Time and Size Pro-Rata execution algorithms.

<sup>16</sup> Price-Time allocations are filled among Customer orders in time priority as described above in this Purpose section.

<sup>17</sup> The Specialist allocation is described above in the Purpose section.

<sup>18</sup> The term “off-floor broker-dealer order” means an order delivered from off the floor of the Exchange by or on behalf of a broker-dealer for the proprietary account(s) of such broker-dealer, including an order for a market maker located on an exchange or trading floor other than the Exchange’s trading floor delivered for the proprietary account(s) of such market maker.

which includes orders of all market participants, excluding Customers and Specialists because they have already been allocated. In addition, as part of the Size Pro-Rata allocation to the Specialists and DROTs, the Exchange may apply a Specialist Participation Entitlement or DROT Priority.<sup>19</sup> Each step is described below in greater detail and the addition of new language is addressed below as well.

*Customer Priority*

As is the case today, Customer orders are always allocated first at a given price. The Exchange will continue to prioritize orders by the highest bid and lowest offer, except that Customer orders shall have priority over non-Customer interest at the same price, provided the Customer order is an executable order.<sup>20</sup> If there are two or more Customer orders for the same options series at the same price, priority shall be afforded to such Customer orders in the sequence in which they are received by the trading system (hereinafter “System”).<sup>21</sup> No participant shall be entitled to receive a number of contracts that is greater than the size that is associated with their quotation or order.

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<sup>19</sup> A Specialist or ROT that receives a Directed Order is a DROT. The term “Directed Order” means any order (other than a stop or stop-limit order as defined in Rule 1066) to buy or sell which has been directed to a particular specialist, Remote Streaming Quote Trader or “RSQT”, or Streaming Quote Trader or “SQT” by an Order Flow Provider. See Phlx Rule 1080(1)(i)(A).

<sup>20</sup> An executable order would be for example a non-contingent order or a contingent order that can have its contingency satisfied, such as an All-or-none order. All-or-none (“AON”) means a contingency market or limit order which is to be executed in its entirety or not at all. Of note, Customer AON would not be considered a “Protected Bid” or “Protected Offer” pursuant to Phlx Rule 1083(o), because it is non-displayed interest.

<sup>21</sup> See proposed Phlx Rule 1089(A)(1)(i).

Currently, Customer priority is described at Rule 1014(g)(viii)(A) which refers to Rule 1014(g)(i)(A).<sup>22</sup> The current rule text simply states that public customer market and marketable limit orders are executed first. The Exchange believes that its proposed rule text, which is similar to BX Rules at Chapter VI, Section 10(1)(C)(1)(a), provides more clarity to the current rule text in explaining the manner in which Customer orders are being allocated. The manner in which Customer orders are allocated is not being amended, simply restated for clarity. For purposes of this Rule, a Customer order does not include a Professional Order.<sup>23</sup> The Exchange believes that is consistent with the protection investors and the public interest to have a rule which clearly spells out the allocation in time of sequence.

*Enhanced Specialist Priority*

Current Rule 1014(g)(vii)(B)(1)(c) describes Enhanced Specialist Participation as follows: “For options subject to the Enhanced Specialist Participation as set forth in Rule 1014(g)(ii), the specialist shall be entitled to receive a number of contracts (not to exceed

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<sup>22</sup> Phlx Rule 1014(g)(i)(A) states that equity option, index option and U.S. dollar-settled foreign currency option orders of controlled accounts are required to yield priority to customer orders when competing at the same price. BX Rules at Chapter VI, Section 10(1)(C)(1)(a) similarly prioritizes customer orders first.

<sup>23</sup> The term Professional means any 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). A professional will be treated in the same manner as an off-floor broker-dealer for purposes of Rules 1014(g)(except with respect to all-or-none orders, which will be treated like customer orders, except that orders submitted pursuant to Phlx Rule 1080(n) for the beneficial account(s) of professionals with an all-or-none designation will be treated in the same manner as off-floor broker-dealer orders), 1033(e), 1064.02 (except professional orders will be considered customer orders subject to facilitation), 1080(n) and 1080.07 as well as Options Floor Procedure Advices B-6 and F-5. Member organizations must indicate whether orders are for professionals. See Phlx Rule 1000(14).



the size of the specialist's quote) that is the greater of the amount he would be entitled to receive pursuant to Rule 1014(g)(ii), or the amount he would otherwise receive pursuant to the operation of the algorithm described above.”

The Exchange notes that in proposed Rule 1089(A)(1)(ii), the allocation described in current Rule 1014 g)(vii)(B)(1)(c) is not being amended. After all Customer orders have been fully executed, upon receipt of an order, provided the Specialist's bid/offer is at or improves on the Exchange's disseminated price, the Specialists, if any, and ROTs will be afforded entitlements and then to off-floor brokers. The Specialist shall not be entitled to receive a number of contracts that is greater than the displayed size associated with such Specialist.<sup>24</sup> Specialist Participation Entitlements are applied throughout the trading day as well as during the Opening Process,<sup>25</sup> except that, pursuant to subparagraph (A)(1)(ii)(2), the entitlement shall only apply after the opening and shall not apply to auctions. The Exchange is adding clarifying language to provide more detail to the current rule.

Proposed Rule 1089 provides that a Specialist shall receive the greater of (1) Specialist Participation Entitlement; (2) ROT Priority or (3) DROT Priority. Today, the Exchange's current rule text states, “For options subject to the Enhanced Specialist Participation as set forth in Rule 1014(g)(ii), the specialist shall be entitled to receive a number of contracts (not to exceed the size of the specialist's quote) that is the greater of the amount he would be entitled to receive pursuant to Rule 1014(g)(ii), or the amount he

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<sup>24</sup> See current rule text at Rule 1014(g)(vii)(B)(1)(c).

<sup>25</sup> See proposed Rule 1089(A)(1)(ii).

would otherwise receive pursuant to the operation of the algorithm...”<sup>26</sup> The Exchange would continue to allocate to the Specialist the greater of the (1) Specialist Participation Entitlement or the (2) ROT Priority. The Exchange’s proposal adds a new allocation option for the Specialist. The Exchange proposes to offer the greater of the (1) Specialist Participation Entitlement; (2) ROT Priority or (3) DROT Priority, when the Specialist is the DROT, similar to BX.<sup>27</sup> Only the addition of the DROT priority is new, the remainder of this provision regarding this allocation exists today in the Phlx Rule. The Exchange is proposing to adopt the portion relating to the DROT Priority, similar to BX Rules. The Exchange believes that the addition of the DROT allocation is consistent with the Act because it serves to protect investors and the public interest by making clear when the DROT allocation would apply. Today, the rule is unclear as the priority of that allocation among Specialists.

As is the case today, the Specialist Participation Entitlement is applicable when the Specialist is at the same price with at least one other SQT or RSQT and the order is for number of contracts greater than 5.<sup>28</sup> As proposed, the Specialist is entitled to receive the greater of his Size Pro-Rata share, DROT Priority when the Specialist is the DROT, or the Enhanced Specialist Priority which is an enhanced participation of at least a certain percentage of the remainder of the order depending on the number or ROTs. The Specialist Participation Entitlement shall be 60% of remaining interest if there is one other ROT at that price. The Specialist Participation Entitlement shall be 40% of

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<sup>26</sup> See current rule text at Phlx Rule 1014(g)(vii)(B)(1)(c).

<sup>27</sup> See BX Rules at Chapter VI, Section 10(1)(C)(2)(ii)(1).

<sup>28</sup> See Phlx Rule 1014(g)(vii)(B)(1)(a).

remaining interest if there are two ROTs at that price. Finally, the Specialist Participation Entitlement 30% of remaining interest if there are more than two other ROTs at that price.<sup>29</sup>

Current Rule 1014(g)(vii)(B) states, “[q]uotations entered electronically by the specialist, an RSQT or an SQT that do not cause an order resting on the limit order book to become due for execution may be matched at any time by quotations entered electronically by the specialist and/or other SQTs and RSQTs, and by ROT limit orders and shall be deemed to be on parity, subject to the requirement that orders of controlled accounts must yield priority to customer orders as set forth in Rule 1014(g)(i)(A).” Rule 1014(g)(i)(A)(1) states, “The Enhanced Specialist Participation is a percentage of the Remainder of the Order to which the specialist is entitled.” Rule 1014(g)(ii) describes the Enhanced Specialist Participation as follows”

‘In equity option, index option and U.S. dollar-settled foreign currency options classes, when the registered specialist is on parity with a controlled account as defined in subparagraph (i) above, in accordance with Exchange Rules 119 and 120 and the number of contracts to be bought or sold is greater than five, the specialist is entitled to receive an enhanced participation of 30% of the Remainder of the Order (“Enhanced Specialist Participation”), except in the following circumstances: (1) where there is one controlled account on parity, the specialist is entitled to receive 60% of the Remainder of the Order; or (2) where there are two controlled accounts on parity, in which case, the specialist is entitled to receive 40% of the Remainder of the Order.’

The Exchange is not amending the percentages related to Specialist Enhanced Participation with this proposal nor the application therein.<sup>30</sup>

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<sup>29</sup> See proposed Phlx Rule 1089(A)(1)(ii)(1)(a).

<sup>30</sup> The language proposed herein tracks language similar to BX Rules at Chapter VI, Section 10(1)(C)(2)(ii). The Specialist is similar to a Lead Market Maker or “LMM” on BX.

*Directed Orders*

Current Rule 1014(g)(viii) describes the manner in which Directed Orders are allocated. Directed Orders (as defined in Rule 1080(1)(i)(A)) that are executed electronically shall be automatically allocated as follows:

(A) First, to customer limit orders resting on the limit order book at the execution price. (B) Thereafter, contracts remaining in the Directed Order, if any, shall be allocated automatically as follows: (1) The Directed Specialist (where applicable), shall be allocated a number of contracts that is the greater of: (a) the proportion of the aggregate size at the NBBO associated with such Directed Specialist's quote, SQT and RSQT quotes, and non-SQT ROT limit orders entered on the book at the disseminated price represented by the size of the Directed Specialist's quote; (b) the Enhanced Specialist Participation as described in Rule 1014(g)(ii); or (c) 40% of the remaining contracts.

A Specialist or ROT who receives a Directed Order is a "DROT" with respect to that Directed Order. Today, the Exchange allocates Directed Orders first to Customer orders. After all Customer orders have been fully executed, upon receipt of a Directed Order, provided the DROT's bid/offer is at the better of the internal PBBO<sup>31</sup> excluding AON orders or the NBBO, the DROT receives a participation entitlement (DROT Priority). If the Specialist is the DROT, the Specialist receives the entitlement. The DROT is not entitled to receive a number of contracts that is greater than the displayed size at a given price point associated with such DROT. DROT participation entitlements are considered after the Opening Process. Pursuant to the DROT participation entitlement when the Specialist is the DROT, the DROT receives, with respect to a Directed Order, the greater of (1) the proportion of the aggregate size at the NBBO associated with such DROT's quote, Specialist quote or order (if not the DROT), SQT and RSQT quotes or orders, and non-SQT ROT limit orders entered on the book at the

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<sup>31</sup> The PBBO is the Exchange's best bid or offer.

disseminated price represented by the size of the DROT's quote; (2) 40% of remaining interest; or (3) the Specialist Participation Entitlement in subsection 1089(A)(1)(ii)(1)(c) (if the DROT is also the Specialist).<sup>32</sup> The Exchange is not amending the DROT Priority, rather the Exchange is relocating the current rule text into a format similar to that of BX Rules at Chapter VI, Section 10(1)(C)(2)(iii). The Exchange proposes to make clear within the new rule text, when two different allocations apply, which allocation the Specialist is entitled to receive.

As is the case today, if there are multiple DROT quotes or orders at the same price which are at or improve on the NBBO when the Directed Order is received, the DROT participation entitlement applies only to the DROT quote or order which has the highest time priority at the first price executed upon receipt of the Directed Order which is equal to or better than the NBBO; the DROT quote or order that received the Directed Order may not receive any further allocation of the Directed Order, except as described in DROT Priority below. If rounding would result in an allocation of less than one contract, the DROT shall receive one contract. As is the case today, if the DROT Priority is not awarded at the time of receipt of the Directed Order, no DROT priority will apply and the order will be handled as though it were not a Directed Order for the remainder of the life of the order. The Exchange is not amending the DROT Priority, rather the Exchange is relocating the current rule text into a format similar to that of BX Rules at Chapter VI, Section 10(1)(C)(2)(iii). As is the case today, under no circumstances would the DROT quote receive an allocation of greater than 40% of an order at a price at which they

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<sup>32</sup> See proposed Phlx Rule 1089(A)(1)(iii). See similar rule text in Phlx Rule 1014(g)(viii)(A) and (B).

receive a directed entitlement, unless it resulted from the allocation of remaining contracts.

Today, as noted above, Directed Orders are first allocated to Customers, then to the Directed Specialist as specified in Rule 1014(g)(viii)(A) and (B).<sup>33</sup> The Exchange today applies a Size Pro-Rata execution algorithm to electronic orders, as described herein, other than Customers, including for Directed Orders. Currently, Rule 1014(g)(viii)(B)(1) and (2) describe the allocation algorithm utilizing a formula to explain the manner in which SQTs and RSQTs quoting at the disseminated price, and non-SQT ROTs that have placed limit orders on the limit order book via electronic interface at the Exchange's disseminated price shall be allocated contracts:

$$\frac{\text{Equal percentage based on the Number of SQTs, RSQTs and Non-SQT ROTs quoting or with limit orders at BBO (Component A)}}{\text{Pro rata percentage based on size of SQT, RSQT and Non-SQT quotes and limit orders (Component B)}} + \frac{\text{Remaining Order Size}}{\text{Order Size}}$$

The current rule at 1014(g)(viii)(B)(1) and (2) describes the weighting. The Exchange proposes to eliminate this formula and process for setting the final weighting and instead utilize the allocation rule text described herein, which the Exchange believes provides more clarity and consistency to the manner in which the allocation method is described for Directed Orders.

<sup>33</sup> Phlx Rule 1014(g)(viii)(B) proposes that after Customer limit orders resting on the book are allocated, the contracts remaining in the Directed Order, if any, shall be allocated automatically as follows: (1) The Directed Specialist (where applicable), shall be allocated a number of contracts that is the greater of: (a) the proportion of the aggregate size at the NBBO associated with such Directed Specialist's quote, SQT and RSQT quotes, and non-SQT ROT limit orders entered on the book at the disseminated price represented by the size of the Directed Specialist's quote; (b) the Enhanced Specialist Participation as described in Rule 1014(g)(ii); or (c) 40% of the remaining contracts.

First, the Exchange proposes in Rule 1089(A)(1)(ii)(1)(c), rule text which permits a Directed Specialist to receive the DROT Priority if that allocation number were the greater number as between the Specialist Participation Entitlement, the ROT Priority and the DROT Priority. BX Rules permit such an allocation pursuant to BX Rules at Chapter VI, Section 10(1)(C)(2)(iii). As proposed in Rule 1089, only one allocation would be available to the Specialist. This proposal would permit the Directed Specialist to receive the DROT Priority if that would result in the greatest allocation. The Exchange is seeking in this rule change to provide clarity around which allocation applies if multiple allocations are available.

The Exchange proposes a new provision which would state, when a Directed Order is received and the DROT's quote is at or improves on the NBBO and the Specialist is at the same price level and is not the DROT, the Specialist participation entitlement set forth proposed Rule 1089(A)(1)(ii)(1) will not apply with respect to such Directed Order. BX's Rules at Chapter VI, Section 10(1)(C)(2)(ii)(1) provide for this restriction by prioritizing Specialists and DROTs at the same price level which are at or improve the NBBO. Today, the Exchange does not apply the Specialist Participation Entitlement in this scenario. Adopting the BX language will bring specificity to proposed Rule 1089 where these priorities intersect for a certain and uniform outcome.

Next, with respect to an order of 5 contracts or fewer that is directed to a DROT who is not the Specialist, quoting at better than the NBBO, the Exchange proposes that Rule 1089(A)(1)(ii)(1) shall not apply.<sup>34</sup> Today, the Exchange does not apply the Specialist Entitlement in this scenario. Adopting this new language which is similar to

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<sup>34</sup> This is similar to BX Rules at Chapter VI, Section 10(C)(2)(ii)(2).

BX Rules at Chapter VI, Section 10(1)(C)(2)(ii)(2) will bring specificity to the rule with respect to the intersection of these priorities for a certain and uniform outcome. The Exchange believes that the addition of these new provisions will enhance competition by affording the Exchange the opportunity to compete for directed order flow.

The Exchange notes that current Rule 1014(g)(viii)(C) indicates that if the Directed Order is for a size that is greater than the Exchange's disseminated size, remaining contracts shall be allocated manually in accordance with Exchange Rule 1014(g)(v). The Exchange notes that this language is outdated and does not apply to the manner in which the Exchange allocates Directed Orders today. Today, all allocations are done within the System; no allocation is handled manually. The Exchange is removing this provision to update its rules. The Exchange believes that removing outdated language is consistent with the Act and the protection of investors and the public interest because the rule text is confusing and outdated and removing it brings greater clarity to the rule.

The Exchange notes at proposed Rule 1089(A)(1)(vi) that only one participation entitlement, Specialist or DROT, may be applied on a given order or quote.<sup>35</sup> Although the Exchange applies no more than one participation entitlement today on a given quote or order, the Exchange is adopting this language to add further clarity to proposed Rule 1089. The Exchange believes the addition of this rule text is consistent with the Act because provide more specificity in the current rules protects investors and the public interest because the rules are clear.

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<sup>35</sup> This is similar to BX Rules at Chapter VI, Section 10(1)(C)(2)(v).



*ROT Priority*

Current Rule 1014(g)(vii)(A) provides that “[I]f the specialist, an SQT, RSQT or a non-SQT ROT that has placed a limit order on the limit order book (“Phlx XL Participant”) is quoting alone at the disseminated price and their quote is not matched by another Phlx XL participant prior to execution, such Phlx XL Participant shall be entitled to receive a number of contracts up to the size associated with his/her quotation.”

The Exchange notes that it is not amending the manner in which ROTs are allocated. Proposed Rule 1089(A)(1)(iv) describes ROT Priority. After all Customer orders have been fully executed at a given price, provided the Customer order is an executable order, and Specialist Participation Entitlement or DROT Priority are applied, if applicable, remaining ROT interest shall have priority over all other orders at the same price. If there are two or more ROT quotes or orders for the same options series at the same price, those shall be executed based on the Size Pro-Rata execution algorithm. If there are contracts remaining, such contracts shall be allocated by randomly assigning all ROTs an order of allocation each trading day, and allocating orders, quotes and sweeps in accordance with the trading day’s order assignment, provided the ROT is at the price at which the order, quote or sweep is being traded.<sup>36</sup>

The Exchange’s amendment to indicate the manner in which remaining contracts are allocated among market participants is new. This language specifies that for ROTs, remaining contracts are allocated among equally priced ROTs, by random assignment of ROTs, each trading day in accordance with the trading day’s order assignment, provided the ROT is at the price at which the order is being traded. With respect to off-floor

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<sup>36</sup> This is similar to Market Maker Priority on BX at Chapter VI, Section 10(C)(2)(iv).

broker-dealers, residual contracts after Size Pro-Rata allocation are allocated in time priority, provided the off-floor broker-dealers are at the price at which the order is being traded. The Exchange believes that this new text that addresses allocation of remaining contracts, which is being applied uniformly for all ROTs, and separately for all off-floor broker-dealers, is consistent with the Exchange Act because it provides for the equitable allocation of contracts among the Exchange's market participants of similar priority. With respect to off-floor broker-dealers, the method is consistent with the Act because it relies simply on time priority, an accepted method of allocation utilized by many options exchange to prioritize orders.

Specifically, with respect to the new text regarding the allocation method for remaining contracts for ROTs, this random assignment is basically a round robin approach to the allocation. The Exchange believes that this method results in a fair and equitable allocation of contracts to these market participants because each trading day the Exchange creates a new order of assignment to allocate ROTs and that order provides an independent method to assign evenly among ROTs. Also, each trading day that assignment changes so that no one ROT would have the ability to receive a greater allocation than another ROT. The Exchange believes that its assignment method is not subject to gaming since it is random and therefore complies with the Act because it is aimed at the protection of investors and the public interest. Also, this rule change will provide market participants with transparency as to the number of contracts that they are entitled to receive as the result of the allocation of remaining contracts.

*All Other Remaining Interest*

Current Rule 1014(g)(vii)(B)(1)(d) provides, with respect to Off-Floor Broker-Dealer Orders:

if any contracts remain to be allocated after the Phlx XL Participants have received their respective allocations, off-floor broker-dealers (as defined in Rule 1080(b)(i)(C)) that have placed limit orders on the limit order book which represent the Exchange's disseminated price shall be entitled to receive a number of contracts that is the proportion of the aggregate size associated with off-floor broker-dealer limit orders on the limit order book at the disseminated price represented by the size of the limit order they have placed on the limit order book. Such off-floor broker-dealers shall not be entitled to receive a number of contracts that is greater than the size that is associated with each such limit order.

Proposed Rule 1089(A)(1)(v) provides, with respect to all other remaining interest, if there are contracts remaining after all ROT interest has been fully executed, such contracts shall be executed based on the size Pro-Rata execution algorithm.<sup>37</sup> In the event that there are remaining contracts to be allocated after allocating based on the size Pro-Rata algorithm, such remaining contracts will be allocated in time priority, one at a time, provided the off-floor broker-dealers, which includes orders of all market participants other than Customers, ROTs and Specialists, are at the price at which the order is being traded. This practice of allocation is not being amended, rather the rule text is being amended to make it clear.

#### *Other Sections*

Rule 1014(g)(vii)(B)(1)(e) provides that no Phlx XL Participant shall be entitled to receive a number of contracts that is greater than the size that is associated with their quotation or limit order. This concept is expressed within proposed Rule 1089 throughout the proposed rule text rather than in a lone standing rule. The Exchange believes that this additional language is no longer necessary because this concept is embedded in the new proposed language.

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<sup>37</sup> This is the manner in which the Exchange allocates remaining interest today pursuant to Rule 1014(g)(vii)(B)(1)(d). Also, the rule text is similar to of BX Rules at Chapter VI, Section 10(1)(C)(2)(iv).

Rule 1014(g)(vii)(2) entitled “*No Split-Price Executions*,” provides [i]f the size associated with a market order or an electronic quotation to be executed is received for a greater number of contracts than the Exchange’s disseminated size, the portion of such an order or quotation executed automatically at the Exchange’s disseminated size shall be allocated automatically in accordance with Rule 1014(g)(vii). Contracts remaining in such an order shall be represented by the specialist and handled in accordance with Exchange Rules.” The Exchange notes that this language is obsolete and not in effect today. The Exchange does not permit any manual handling of orders. The Exchange believes that it is consistent with the Act and the protection of investors and the public interest to eliminate this obsolete language to provide clarity to members as to the manner in which the System allocates trades.

Current Rule 1014(g)(vii)(B)(3) provides that notwithstanding the first sentence of Rule 1014(g)(i), neither Rule 119(a)-(d) and (f), nor Rule 120 (insofar as it incorporates those provisions by reference) shall apply to the allocation of automatically executed trades. The Exchange notes that Rules and 120 are being disconnected from the electronic allocation model. The Exchange is proposing to create a new Rule for electronic allocation, as compared to floor allocation. Proposed Phlx Rule 1089 will not rely on concepts of controlled accounts or parity and therefore the application to Rules 119 and 120 is unnecessary. The proposed rule is structured to indicate the manner in which market participants will be allocated in reference to each other in a more streamlined manner. The Exchange believes that deleting this rule text is consistent with the Act, specifically the protection of investors and the public interest because this rule

text does not serve to describe in a clear manner the method in which the Exchange allocated electronic transactions.

#### Cross-References

The Exchange is amending the references to Rule 1014 in Rule 1082, Commentary .02 and .03 to update the references to the new proposed rule.

#### Behavior Changes with this Proposal

With this proposal, there are three new provisions which result in behavior which does not exist today on Phlx.

First, the Exchange proposes rule text in proposed Rule 1089(A)(1)(ii)(1) which would permit a Specialist to receive the DROT Priority if that allocation number were the greater number as between the Specialist Participation Entitlement, the ROT Priority and the DROT Priority. Only one allocation would be available to the Specialist, as is the case today. This proposal would permit the Specialist to receive the DROT Priority if that were the greater allocation number. The Exchange's proposal to add rules similar to BX which address the intersection between the DROT and Specialist is consistent with the Act because the natural conflicts as between the entitlements is addressed in more detail and consistent with the manner in which BX operates today. The Exchange will permit a Specialist to receive the higher of all entitlements pursuant to proposed Rule 1089. The new language at proposed Rule 1089(A)(1)(ii)(1)(c) recognizes that a Specialist could be the DROT and receive a higher allocation.

Second, the Exchange proposes that when a Directed Order is received and the DROT's quote is at or improves on the NBBO and the Specialist is at the same price level and is not the DROT, the Specialist participation entitlement set forth proposed Rule 1089(A)(1)(ii)(1) will not apply with respect to such Directed Order.

Third, with respect to an order of 5 contracts or fewer that is directed to a DROT who is not the Specialist, quoting at or better than the NBBO, proposed Rule 1089(A)(1)(ii)(2) shall not apply. The Exchange's proposed text at proposed Rule 1089(A)(2) makes clear that if the order of 5 contracts or fewer were directed to a DROT who is not the Specialist, quoting at or better than the NBBO, the provision related to the allocation to the Specialist at 1089(A)(2) would not apply. The Exchange believes that conforming the intersection between Specialist and DROT entitlements to BX rules will not only offer Exchange members the same opportunities for allocation as BX Participants, but will also bring certainty to the Exchange' allocation rules when multiple priorities may apply. Also with respect to the 5 contracts or fewer the Exchange is adding more specificity to proposed Rule at 1080(A)(1)(ii)(2) as the Exchange has noted within this proposal.

Below are some examples of Specialist allocation pursuant to the Size Pro-Rata model.

***Example Number 1:***

ABBO = 1.00 – 1.10

PBBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

Specialist: 1.00 bid (10 contracts) – 1.10 offer (15 contracts)

Customer A: 5 contracts offered at 1.10

Firm: 5 contracts offered at 1.10

ROT 1: 1.00 bid (10 contracts) – 1.10 offer (20 contracts)

ROT 2: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)

Customer B: 2 contracts offered at 1.10

Incoming Order to pay 1.10 for 40 contracts

Allocated as follows:

Size Pro-Rata results in Customer A trading 5 contracts, Customer B trading 2 contracts, Specialist trading 11 contracts ( $15/45 \times 33$  remaining), ROT1 trading 14 contracts ( $20/45 \times 33$ ), ROT2 trading 7 contracts ( $10/45 \times 33$ ), and then Specialist receiving an additional 1 lot based on random assignment.

Specialist Participation Entitlement would result in Customer A trading 5 contracts, Customer B trading 2 contracts, and Specialist trading 40% of remaining 33 contracts = 13 (13.2 rounded down); then Size Pro-Rata for remaining with ROT1 trading 13 contracts ( $20/30 \times 20$ ) and ROT2 trading 6 contracts ( $10/30 \times 20$ ) and Specialist trading an additional 1 lot based on random assignment.

The Specialist Participation Entitlement would prevail in this example, pursuant to proposed Rule 1089(A)(1)(ii)(1), because the Specialist Participation Enhancement receives greater allocation.

***Example Number 2:***

ABBO = 1.00 – 1.10

PBBO = 1.00 – 1.10 comprised of the following in order of receipt

Orders/Quotes entered into Trading System in the following order of receipt:

ROT 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)

Customer A: 10 contracts offered at 1.10

Firm: 15 offered at 1.10

Specialist: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)

ROT 2: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)

Customer B: 10 contracts offered at 1.10

Incoming Order to pay 1.10 for 40 contracts

Allocated as follows:

Size Pro-Rata results in Customer A trading 10 contracts, Customer B trading 10 contracts, Specialist trading 6 contracts (10/30\*20 remaining rounded down), ROT1 trading 6 contracts (10/30\*20), ROT2 trading 6 contracts (10/30\*20), and then ROT1 and Specialist each receiving an additional 1 lot based on random assignment.

Specialist Participation Entitlement would result in Customer A trading 10 contracts, Customer B trading 10 contracts, and Specialist trading 40% of remaining 20 contracts = 8; then normal pro rata resumes with ROT1 and ROT2 each being allocated 6 contracts.

Pursuant to proposed Rule 1089(A)(1)(ii)(1), the Specialist Participation Entitlement would prevail in this example because the Specialist Participation Entitlement receives greater allocation.

***Example Number 3:***

ABBO = 1.00 – 1.10

PBBO = 1.00 – 1.10

Orders/Quotes entered into Trading System in the following order of receipt:

ROT 1: 1.00 bid (10 contracts) – 1.10 offer (10 contracts)

Firm: 25 offered at 1.10

Specialist: 1.00 bid (10 contracts) – 1.10 offer (20 contracts)

ROT 2: 1.00 bid (5 contracts) – 1.10 offer (10 contracts)



ROT 3 1.00 bid (10 contracts) – 1.10 offer (20 contracts)

Customer B: 2 contracts offered at 1.10

Incoming Order to pay 1.10 for 40 contracts

Allocated as follows:

Size Pro-Rata results in Customer B trading 2 contracts, ROT1 trading 6 contracts (10/60\*38), Specialist trading 12 (20/60\*38), ROT2 trading 6 contracts (10/60\*38), and ROT3 trading 12 contracts (20/60\*38) and then ROT1 and Specialist each trading an additional 1 contract by random assignment.

Specialist Participation Entitlement would result in Customer B trading 2 contracts and Specialist trading 30% of remaining 38 contracts = 11 (11.4 rounded down); then normal pro rata resumes and ROT1 trades 6 contracts (10/40\*27), ROT2 trades 6 (10/40\*27), and ROT3 trades 13 contracts (20/40\*27) and ROT1 and Specialist each trade an additional 1 lot by random assignment.

Size Pro-Rata allocation would prevail because the Specialist Participation Entitlement receives greater allocation pursuant to proposed Rule 1089(A)(1)(ii)(1)

Below are some examples of DROT Participation Entitlement under Size Pro-Rata Algorithm. Examples 1 through 3 below illustrate the manner in which a DROT will be allocated pursuant to the Size Pro-Rata model.

***Example Number 1:***

Assume a Specialist is assigned and the DROT is **not** the Specialist.

ABBO = 1.00 – 1.10

PBBO = 1.00 – 1.10 comprised of the following in order of receipt:

Specialist: 1.00 (10) – 1.10 (15)

Customer A: 5 offered at 1.10

Firm: 5 offered at 1.10

DROT: 1.00 (10) – 1.10 (20)

ROT1: 1.00 (10) – 1.10 (10)

Customer B: 2 offered at 1.10

Incoming Directed Order to pay 1.10 for 40 contracts.

Determination of Allocation:

Size Pro-Rata would result in Customer A trading 5, Customer B trading 2, Specialist trading 11 ( $15/45 \cdot 33$  remaining), DROT trading 14 ( $20/45 \cdot 33$ ), ROT1 trading 7 ( $10/45 \cdot 33$ ), and then Specialist receiving the residual 1 lot based on random assignment.

DROT Priority would result in Customer A trading 5, Customer B trading 2, and DROT trading 40% of remaining  $33 = 13$  (13.2 rounded down); then normal Size Pro-Rata for remaining with the Specialist trading 12 ( $15/25 \cdot 20$ ) and ROT1 trading 8 ( $10/25 \cdot 20$ ).

The Specialist Participation Entitlement would not be calculated since the Specialist is not the DROT.

In this example, the Size Pro-Rata allocation would prevail since the DROT would receive the greater allocation this way.

***Example Number 2:***

Assume that no Specialist is present.

ABBO = 1.00 – 1.10

PBBO = 1.00 – 1.10 comprised of the following in order of receipt:

DROT: 1.00 (10) – 1.10 (15)  
 Customer A: 5 offered at 1.10  
 Firm: 5 offered at 1.10  
 ROT1: 1.00 (10) – 1.10 (20)  
 ROT2: 1.00 (10) – 1.10 (10)  
 Customer B: 2 offered at 1.10

Incoming Directed Order to pay 1.10 for 40 contracts.

Determination of Allocation:

Size Pro-Rata would result in Customer A trading 5, Customer B trading 2, DROT trading 11 ( $15/45*33$  remaining), ROT1 trading 14 ( $20/45*33$ ), ROT2 trading 7 ( $10/45*33$ ), and the DROT receiving the residual 1 lot based on random assignment.

DROT Priority would result in Customer A trading 5, Customer B trading 2, and DROT trading 40% of remaining  $33 = 13$  (13.2 rounded down); then normal Size Pro-Rata for remaining with ROT1 trading 13 ( $20/30*20$ ) and ROT2 trading 6 ( $10/30*20$ ), and the DROT receiving the residual 1 lot based on random assignment.

The Specialist Participation Entitlement would not be calculated since the Specialist is not the DROT.

In this example, the DROT Priority would prevail since the DROT Priority would receive the greater allocation this way.

### **Example Number 3:**

Assume that the DROT is **also** the Specialist.

ABBO = 1.00 – 1.10

PBBO = 1.00 – 1.10 comprised of the following in order of receipt:

DROT/Specialist: 1.00 (10) – 1.10 (15)  
 Customer A: 5 offered at 1.10  
 Firm: 5 offered at 1.10  
 ROT1: 1.00 (10) – 1.10 (30)  
 Customer B: 2 offered at 1.10

Incoming Directed Order to pay 1.10 for 40 contracts.

Determination of Allocation:

Size Pro-Rata would result in Customer A trading 5, Customer B trading 2, DROT/Specialist trading 11 ( $15/45 \times 33$  remaining), ROT1 trading 22 ( $30/45 \times 33$ ).

DROT Priority would result in Customer A trading 5, Customer B trading 2, and DROT/Specialist trading 40% of remaining 33 = 13 (13.2 rounded down); then Size Pro-Rata for remaining with ROT1 trading full size of 20.

The Specialist Participation Entitlement would result in Customer A trading 5, Customer B trading 2, and DROT/Specialist entitled to 60% of remaining 33 = 19 (19.8 rounded down) but capped at his size of 15 thus trading 15; then normal Size Pro-Rata for remaining with ROT1 trading 18.

In this example, the Specialist Participation Entitlement would prevail since the DROT is the Specialist and would receive a greater allocation this way.

#### Examples with Rounding and Remainders

##### ***Example Number 1:***

Presume an order of 200 contracts is being allocated in the Exchange's Order Book. Allocation will first occur with Customer orders at the best price filled in time priority, since Customers always have priority on the Exchange. Presume there are 63 contracts remaining after Customer orders are filled. Assume no Specialist is present thus, ROTs would be allocated next pursuant to Rule 1089 in Size Pro-Rata fashion. Presume 5 ROTs are at the best price and the allocation of the remaining 63 contracts, after Customer orders have been satisfied, is as follows:

ROT A  $1.10(30) \times 1.20(30)$  --- 25.2 rounded down to 25 contracts

ROT B  $1.10(15) \times 1.20(15) \text{ --- } 12.6$  rounded down to 12 contracts

ROT C  $1.10(10) \times 1.20(10) \text{ --- } 8.4$  rounded down to 8 contracts

ROT D  $1.10(10) \times 1.20(10) \text{ --- } 8.4$  rounded down to 8 contracts

ROT E  $1.10(10) \times 1.20(10) \text{ --- } 8.4$  rounded down to 8 contracts

After this Size Pro-Rata allocation, 2 contracts remain to be allocated. Presume for this trading day these ROTs are assigned the following order of assignment: first is ROT A, second is ROT B, third is ROT C, fourth is ROT D and fifth is ROT E. The 2 remaining contracts would be allocated as follows:

ROT A  $1.10(30) \times 1.20(30) \text{ --- } 1$  contract

ROT B  $1.10(15) \times 1.20(15) \text{ --- } 1$  contract

ROT C  $1.10(10) \times 1.20(10) \text{ --- } \text{zero}$

ROT D  $1.10(10) \times 1.20(10) \text{ --- } \text{zero}$

ROT E  $1.10(10) \times 1.20(10) \text{ --- } \text{zero}$

The next order which results in contracts remaining after the Size Pro-Rata allocation to ROTs will have such remaining contracts allocated one at a time beginning with ROT C since he was next in line based on that trading day's order of assignment, provided ROT C is at the best price with remaining interest.

***Example Number 2:***

Presume an order of 200 contracts is being allocated in the Exchange's Order Book.

Presume all Customer orders and ROT interest that was at the best price have been filled and there remains 9 contracts to be executed.

Off-floor broker-dealers would be allocated next pursuant to Rule 1089 in a Size Pro-Rata fashion. Presume 3 off-floor broker-dealers are at the best price and their

interest had arrived in the following order. The allocation of the remaining 9 contracts is as follows:

Off-floor broker-dealer C 1.10 (5) x 1.20 (5) – 4.09 contracts rounded down to 4

Off-floor broker-dealer B 1.10 (3) x 1.20(3) – 2.45 contracts rounded down to 2

Off-floor broker-dealer A 1.10 (3) x 1.20(3) – 2.45 contracts rounded down to 2

After this Size Pro-Rata allocation, there remains one contract to be allocated. This residual contract will be allocated in time priority as follows:

Off-floor broker-dealer C 1.10 (5) x 1.20 (5) – 1 contract

Off-floor broker-dealer B 1.10 (3) x 1.20(3) – zero

Off-floor broker-dealer A 1.10 (3) x 1.20(3) -- zero

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>38</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>39</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, by conforming the format of the allocation to that of BX for purposes of comparing the allocation methods and also bringing clarity the electronic allocation rule. Also, the adoption of new rule text will allow the Exchange to effectively compete against other markets. The Exchange has incorporated this rationale into the Purpose Section in this form.

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<sup>38</sup> 15 U.S.C. 78f(b).

<sup>39</sup> 15 U.S.C. 78f(b)(5).

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 does not believe the proposed change will cause any unnecessary burden on inter-market competition because all Exchange members may apply to be either Specialists or ROTs and, presuming all requirements are met, would be entitled to receive participation entitlements provided they direct orders and those orders are executed by those DROT's.

With respect to rounding, all rounding is down to the nearest integer. The Exchange does not believe that the proposal to round all remaining contracts down to the nearest integer imposes an undue burden on competition because the Exchange will uniformly round in this matter.

With respect to allocating remaining contracts, the Exchange does not believe that the proposal to allocate remaining contracts for ROTs by random assignment creates an undue burden on competition because the method, which is basically round robin, results in a fair and equitable allocation of shares of these market participants. The Exchange does not believe that allocating remaining contracts to off-floor broker-dealers in time priority creates an undue burden on competition because the method will be applied uniformly among these participants.

Permitting Specialists to receive an allocation over ROTs when the Specialist is the DROT does not create an undue burden on competition because today Phlx permits the Specialist to be ahead of ROTs generally within its allocation method. Specialists

have higher quoting obligations as compared to ROTs (90% versus 60% of the series in which assigned).<sup>40</sup>

The Exchange's proposal to add new provisions relating to Directed Orders and Specialists does not create an undue burden on competition because BX already has similar rules in place and the new rules bring certainty to the Exchange' allocation rules when multiple priorities may apply.

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:

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<sup>40</sup>

Id.



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-2017-45 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-2017-45. 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-2017-45 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>41</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>41</sup> 17 CFR 200.30-3(a)(12).

**EXHIBIT 5**

New text is underlined>; deleted text is in brackets.

**Nasdaq PHLX Rules**

\* \* \* \* \*

**Options Rules**

\* \* \* \* \*

**Rule 1014. Obligations and Restrictions Applicable to Specialists and Registered Options Traders**

(a) – (f) No change.

(g) *Equity Option, Index Option and U.S. dollar-settled Foreign Currency Option Priority and Parity*

(i) – (vi) No change.

(vii) Reserved. [*Allocation of Automatically Executed Trades.* After public customer market and marketable limit orders have been executed, trades automatically executed in such options shall be allocated automatically in the following manner:

(A) If the specialist, an SQT, RSQT or a non-SQT ROT that has placed a limit order on the limit order book ("Phlx XL Participant") is quoting alone at the disseminated price and their quote is not matched by another Phlx XL participant prior to execution, such Phlx XL Participant shall be entitled to receive a number of contracts up to the size associated with his/her quotation.

(B) *Parity.* Quotations entered electronically by the specialist, an RSQT or an SQT that do not cause an order resting on the limit order book to become due for execution may be matched at any time by quotations entered electronically by the specialist and/or other SQTs and RSQTs, and by ROT limit orders and shall be deemed to be on parity, subject to the requirement that orders of controlled accounts must yield priority to customer orders as set forth in Rule 1014(g)(i)(A).

(1) (a) orders for 5 contracts or fewer shall be allocated first to the specialist, provided, however, that on a quarterly basis, the Exchange will evaluate what percentage of the volume executed on the Exchange is comprised of orders for 5 contracts or fewer allocated to specialists, and will reduce the size of the orders included in this provision if such percentage is over 25%. In order to be entitled to receive the 5 contract or fewer order preference set forth in this sub-paragraph (B)(1)(a), the specialist must be quoting at the Exchange's disseminated price, and shall not be entitled to receive a number of contracts that is greater than the size that is associated with its quote. If the specialist is not quoting at the Exchange's disseminated price at the time of execution, orders for 5 contracts or fewer shall be allocated to Phlx XL Participants on parity as set forth in paragraph (b) below.

(b) Respecting orders for greater than 5 contracts (regardless of whether the specialist is quoting at the Exchange's disseminated price), or orders for 5 contracts or fewer when the specialist is not quoting at the Exchange's disseminated price, inbound electronic orders shall be allocated pursuant to the following allocation algorithm:

$$\frac{\text{Equal percentage based on the number of Phlx XL Participants quoting or with limit orders at BBO (Component A)} + \text{Pro rata percentage based on size of Phlx XL participant quotes/limit orders (Component B)}}{2} \times \text{Incoming Order Size}$$

2

Where:

Component A: The percentage to be used for Component A shall be an equal percentage, derived by dividing 100 by the number of Phlx XL participants quoting at the BBO.

Component B: Size Pro Rata Allocation. The percentage to be used for Component B of the allocation algorithm formula is that percentage that the size of each Phlx XL Participant's quote at the best price represents relative to the total number of contracts in the disseminated quote.

Final Weighting: The final weighting formula for equity options, which shall be determined by a three-member special committee of the Board of Directors, chaired by the President of the Exchange, and two Directors (the "Special Committee" ), and apply uniformly across all equity options, shall be a weighted average of the percentages derived for Components A and B multiplied by the size of the incoming order. Initially, the weighting of components A and B shall be equal, represented mathematically by the formula: (Component A Percentage + Component B Percentage)/2) \* incoming order size.

The final weighting formula for index options and options on Exchange Traded Fund Shares (as defined in Rule 1000(b)(42.)) shall be established by the Special Committee. The final weighting formula for options on U.S. dollar-settled foreign currency options shall be established by a three- member special committee of the Board of Directors, chaired by the President of the Exchange, and two Governors. The final weighting formula may vary by product. Changes made to the percentage weightings of Components A and B shall be announced to the membership on the Exchange's website at least one day before implementation of the change.

- (c) **Enhanced Specialist Participation:** For options subject to the Enhanced Specialist Participation as set forth in Rule 1014(g)(ii), the specialist shall be entitled to receive a number of contracts (not to exceed the size of the specialist's quote) that is the greater of the amount he would be entitled to receive pursuant to Rule 1014(g)(ii), or the amount he would otherwise receive pursuant to the operation of the algorithm described above.
- (d) **Broker-dealer Orders:** If any contracts remain to be allocated after the Phlx XL Participants have received their respective allocations, off-floor broker-dealers (as defined in Rule 1080(b)(i)(C)) that have placed limit orders on the limit order book which represent the Exchange's disseminated price shall be entitled to receive a number of contracts that is the proportion of the aggregate size associated with off-floor broker-dealer limit orders on the limit order book at the disseminated price represented by the size of the limit order they have placed on the limit order book. Such off-floor broker-dealers shall not be entitled to receive a number of contracts that is greater than the size that is associated with each such limit order.
- (e) No Phlx XL Participant shall be entitled to receive a number of contracts that is greater than the size that is associated with their quotation or limit order.
- (2) *No Split-Price Executions.* If the size associated with a market order or an electronic quotation to be executed is received for a greater number of contracts than the Exchange's disseminated size, the portion of such an order or quotation executed automatically at the Exchange's disseminated size shall be allocated automatically in accordance with Rule 1014(g)(vii). Contracts remaining in such an order shall be represented by the specialist and handled in accordance with Exchange Rules.
- (3) Notwithstanding the first sentence of Rule 1014(g)(i), neither Rule 119(a)-(d) and (f), nor Rule 120 (insofar as it incorporates those provisions by reference) shall apply to the allocation of automatically executed trades.
- (viii) Directed Orders (as defined in Rule 1080(l)(i)(A)) that are executed electronically, except for Directed Complex Orders, shall be automatically allocated as follows:
- (A) First, to customer limit orders resting on the limit order book at the execution price.
- (B) Thereafter, contracts remaining in the Directed Order, if any, shall be allocated automatically as follows:
- (1) The Directed Specialist (where applicable), shall be allocated a number of contracts that is the greater of:

- (a) the proportion of the aggregate size at the NBBO associated with such Directed Specialist's quote, SQT and RSQT quotes, and non-SQT ROT limit orders entered on the book at the disseminated price represented by the size of the Directed Specialist's quote;
- (b) the Enhanced Specialist Participation as described in Rule 1014(g)(ii); or
- (c) 40% of the remaining contracts.
- (d) Thereafter, SQTs and RSQTs quoting at the disseminated price, and non-SQT ROTs that have placed limit orders on the limit order book via electronic interface at the Exchange's disseminated price shall be allocated contracts according to the following formula:

Equal percentage based on the Number of SQTs, RSQTs and Non- SQT ROTs quoting or with limit orders at BBO (Component A)	+	Pro rata percentage based on size of SQT, RSQT and Non- SQT quotes and limit orders (Component B)	×	Remaining Order Size
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Where:

*Component A:* The percentage to be used for Component A shall be an equal percentage, derived by dividing 100 by the number of SQTs, RSQTs and non-SQTs quoting or with limit orders at the BBO.

*Component B: Size Pro Rata Allocation.* The percentage to be used for Component B of the allocation algorithm formula is that percentage that the size of each SQT, RSQT or non-SQT ROT's quote or limit order at the best price represents relative to the total number of contracts in the disseminated quote.

*Final Weighting:* The final weighting formula shall be determined by a three-member special committee of the Board of Directors, chaired by the President of the Exchange, and two Directors (the "Special Committee"), and shall be a weighted average of the percentages derived for Components A and B multiplied by the size of the incoming order

(2)

- (a) A Directed RSQT or SQT (where applicable) shall be allocated a number of contracts that is the greater of the proportion of the aggregate size at the NBBO associated with such Directed SQT or RSQT's quote, the specialist's quote, other SQT and RSQT quotes, and non-SQT ROT limit orders entered on the book via electronic interface at the disseminated price represented by the size of the Directed RSQT or SQT's quote at the NBBO, or

(b) 40% of the remaining contracts.

(c) Thereafter, the specialist, SQTs and RSQTs (excluding the Directed SQT or RSQT) quoting at the disseminated price, and non-SQT ROTs that have placed limit orders on the limit order book via electronic interface at the Exchange's disseminated price, shall be allocated a number of contracts according to the following formula:

$$\frac{\text{Equal percentage based on the Number of SQTs, RSQTs, specialist and Non-SQT ROTs quoting or with limit orders at BBO (Component A)}}{\text{Pro rata percentage based on size of SQT, RSQT, specialist and Non-SQT quotes and limit orders (Component B)} + \text{Remaining Order Size}} \times \text{Order Size}$$

Where:

*Component A:* The percentage to be used for Component A shall be an equal percentage, derived by dividing 100 by the number of SQTs, RSQTs (other than the Directed SQT or RSQT) specialist and non-SQTs quoting or with limit orders at the BBO.

*Component B:* Size Pro Rata Allocation. The percentage to be used for Component B of the allocation algorithm formula is that percentage that the size of each SQT, RSQT RSQTs (other than the Directed SQT or RSQT), specialist or non-SQT ROT's quote or limit order at the best price represents relative to the total number of contracts in the disseminated quote.

*Final Weighting:* The final weighting formula shall be determined by a three-member special committee of the Board of Directors, chaired by the President of the Exchange, and two Directors (the "Special Committee"), and shall be a weighted average of the percentages derived for Components A and B multiplied by the size of the incoming order.

(3) If any contracts remain to be allocated after the specialist, SQTs, RSQTs and non-SQT ROTs with limit orders on the limit order book have received their respective allocations, off-floor broker-dealers (as defined in Rule 1080(b)(i)(C)) that have placed limit orders on the limit order book which represent the Exchange's disseminated price shall be entitled to receive a number of contracts that is the proportion of the aggregate size associated with off-floor broker-dealer limit orders on the limit order book at the disseminated price represented by the size of the limit order they have placed on the limit order book.

(C) If the Directed Order is for a size that is greater than the Exchange's disseminated size, remaining contracts shall be allocated manually in accordance with Exchange Rule 1014(g)(v).

(D) A Directed Specialist, RSQT, or SQT shall not be entitled to receive a number of contracts that is greater than the size associated with their quotation. Non-SQT ROTs and off-floor broker-dealers shall not be entitled to receive a number of contracts that is greater than the size associated with their limit order.]

••• *Commentary:* -----

.01 - .19 No change.

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**Rule 1082. Firm Quotations**

(a) – (d) No change

••• *Commentary:* -----

.01 No change.

.02 *Locked Markets.* In the event that an SQT, RSQT, and/or specialist's electronically submitted quotations interact with the electronically submitted quotations of other SQTs, RSQTs and/or the specialist, resulting in the dissemination of a "locked" quotation (e.g., \$1.00 bid - 1.00 offer), the locked quotations will automatically execute against each other in accordance with the allocation algorithm set forth in Rule [1014(g)(vii)]1089.

.03 *Crossed Markets.* The Exchange will not disseminate an internally crossed market (e.g., \$1.10 bid, 1.00 offer). If an SQT, RSQT or specialist electronically submits a quotation ("incoming quotation") that would cross an existing quotation ("existing quotation"), the Exchange will change the incoming quotation such that it locks the existing quotation and automatically execute the locked quotations against each other in accordance with the allocation algorithm set forth in Rule [1014(g)(vii)]1089.

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**Rule 1089. Electronic Execution Priority and Processing in the System**

(A) Execution Algorithm - The Exchange will apply a size Pro-Rata execution algorithm to electronic orders. The order entry system ("System") shall execute trading interest within the System in price priority, meaning it will execute all trading interest at the best price level within the System before executing trading interest at the next best price. If the result is not a whole number, it will be rounded down to the nearest whole number.



(1) Priority Overlays Applicable to size Pro-Rata Execution Algorithm: the Exchange will apply the following designated Participant priority overlays. No participant shall be entitled to receive a number of contracts that is greater than the size that is associated with their quotation or order.

(i) Customer Priority: the highest bid and lowest offer shall have priority except that Customer orders shall have priority over non-Customer interest at the same price, provided the Customer order is an executable order. If there are two or more Customer orders for the same options series at the same price, priority shall be afforded to such Customer orders in the sequence in which they are received by the System. For purposes of this rule a Customer shall be defined as a person or entity that is not a broker or dealer in securities.(ii) Enhanced Specialist Priority: A Specialist may be assigned by the Exchange in each option class in accordance with Phlx Rule 1020. After all Customer orders have been fully executed, upon receipt of an order, provided the Specialist's bid/offer is at or improves on the Exchange's disseminated price, the Specialist will be afforded a participation entitlement. The Specialist shall not be entitled to receive a number of contracts that is greater than the displayed size associated with such Specialist. Specialist participation entitlements will be considered after the Opening Process for subsection (1)(c) which describes the participation entitlement for a Directed Order. The Specialist participation entitlement is as follows below.

(1) Specialist Participation Entitlement: A Specialist shall receive the greater of:

(a) When the Specialist is at the same price with SQT, RSQT or non-SQT ROT (collectively "ROTs") and the number of contracts is greater than 5, the Specialist is entitled to receive an enhanced participation of at least 30% of the remainder of the order ("Specialist Participation Entitlement"); or

(i) 60% of remaining interest if there is one other ROT at that price;

(ii) 40% of remaining interest if there are two other ROTs at that price;

(iii) 30% of remaining interest if there are more than two other ROTs at that price; or

(b) the Specialist's size pro-rata share under (A)(1)(iv) ("ROT Priority"); or

(c) the Directed ROT ("DROT") participation entitlement, if any, set forth in subsection (A)(1)(iii) below (if the order is a Directed Order and the Specialist is also the DROT) ("DROT Priority").

If rounding would result in an allocation of less than one contract, a Specialist shall receive one contract.

Notwithstanding the foregoing, when a Directed Order is received and the DROT's quote or order is at or improves on the NBBO and the Specialist is at the same price level and is not the DROT, the Specialist Participation Entitlement in subsection (A)(1)(ii)(1) will not apply with respect to such Directed Order.

(2) Orders for 5 contracts or fewer shall be allocated to the Specialist, provided, however, that on a quarterly basis, the Exchange will evaluate what percentage of the volume executed on the Exchange is comprised of orders for 5 contracts or fewer allocated to Specialists, and will reduce the size of the orders included in this provision if such percentage is over 25%. In order to be entitled to receive the 5 contract or fewer order preference set forth in this sub-paragraph (A)(1)(ii)(2), the Specialist must have an quote/order at the Exchange's disseminated price with no other interest present which has a higher priority, and shall not be entitled to receive a number of contracts that is greater than the size that is associated with its quote. If the Specialist is not quoting at the Exchange's disseminated best price with no other interest present which has a higher priority at the time of execution, a Specialist is not entitled to priority with respect to the 5 contracts or fewer, however the Specialist is eligible to receive such contracts pursuant to 1089(A)(i)(iv), thereafter orders will be allocated pursuant to 1089(A)(1)(iv). This sub-paragraph (A)(1)(ii)(2) shall only apply after the opening and shall not apply to auctions.

(iii) DROT Priority : After all Customer orders have been fully executed, upon receipt of a Directed Order, provided the DROT's bid/offer is at the better of the internal PBBO excluding AON orders or the NBBO, the DROT will be afforded a participation entitlement. If the Specialist is the DROT, the Specialist will receive the entitlement. The DROT shall not be entitled to receive a number of contracts that is greater than the displayed size at a given price point associated with such DROT. DROT participation entitlements will be considered after the Opening Process. Pursuant to the DROT participation entitlement, the DROT shall receive, with respect to a Directed Order, the greater of:

(1) the proportion of the aggregate size at the NBBO associated with such DROT's quote, Specialist quote or order (if not the DROT), SQT and RSQT quotes or orders, and non-SQT ROT limit orders entered on the book at the disseminated price represented by the size of the DROT's quote;

(2) 40% of remaining interest; or

(3) the Specialist Participation Entitlement in subsection (A)(1)(ii)(1) (if the DROT is also the Specialist).

If there are multiple DROT quotes or orders at the same price which are at the better of the internal PBBO excluding AON orders or the NBBO when the Directed Order is received, the DROT participation entitlement shall apply only to the DROT quote or order which has the highest time priority; the DROT quote or order that received the Directed Order may not receive any further allocation of the Directed Order, except as noted in (iv) below. If rounding would result in an allocation of less than one contract, the DROT shall receive one contract.

(iv) ROT Priority: After all Customer orders have been fully executed, provided the Customer order is an executable order, and Specialist Participation Entitlement or DROT Priority are applied, if applicable, remaining ROT interest shall have priority over all other orders at the same price. If there are two or more ROT quotes or orders for the same options series at the same price, those shall be executed based on the size Pro-Rata execution algorithm. If there are contracts remaining, such contracts shall be allocated by randomly assigning all ROTs an order of allocation each trading day, and allocating orders, quotes and sweeps in accordance with the trading day's order assignment, provided the ROT is at the best price at which the order, quote or sweep is being traded.

(v) All Other Remaining Interest. If there are contracts remaining after all ROT interest has been fully executed, such contracts shall be executed based on the size Pro-Rata execution algorithm. In the event that there are remaining contracts to be allocated for interest after rounding, such remaining contracts will be allocated in time priority, provided the off-floor broker-dealers, which includes orders of all market participants other than Customers, ROTs and Specialists, are at the best price at which the order is being traded.

(vi) Only one participation entitlement, Enhanced Specialist Priority or DROT Priority, may be applied on a given order or quote.

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