Required fields are shown with yellow backgrounds and asterisks.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No.* SR - 2014 - * 24

Amendment No. (req. for Amendments *)

Filing by   NASDAQ OMX PHLX LLC.

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * ☑	Amendment * ☐	Withdrawal ☐	Section 19(b)(2) * ☑	Section 19(b)(3)(A) * ☐	Section 19(b)(3)(B) * ☐

Rule

Pilot ☐	Extension of Time Period for Commission Action * ☐	Date Expires *	

☐ 19b-4(f)(1)   ☐ 19b-4(f)(4)
☐ 19b-4(f)(2)   ☐ 19b-4(f)(5)
☐ 19b-4(f)(3)   ☐ 19b-4(f)(6)

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010

Section 806(e)(1) * ☐

Section 806(e)(2) * ☐

Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934

Section 3C(b)(2) * ☐

Exhibit 2 Sent As Paper Document ☐

Exhibit 3 Sent As Paper Document ☐

Description

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

A proposed rule change to modify the order execution algorithm of Phlx's NASDAQ OMX PSX facility.

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 * John   Last Name * Yetter

Title *   Vice President

E-mail *   john.yetter@nasdaqomx.com

Telephone * (301) 978-8497   Fax   (301) 978-8472

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   04/14/2014

By   Edward S. Knight

Executive Vice President and General Counsel

(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.

Persona Not Validated - 1383935917270,

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS 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

Add   Remove   View

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 Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange

Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] NASDAQ OMX PHLX LLC ("Phlx"

or "Exchange") is filing with the Securities and Exchange Commission ("Commission")

a proposed rule change to modify the order execution algorithm of Phlx's NASDAQ

OMX PSX facility ("PSX").

A notice of the proposed rule change for publication in the Federal Register is

attached hereto as Exhibit 1 and the text of the proposed rule change is attached as

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 Phlx on

April 12, 2014. No other action by Phlx is necessary for the filing of the rule change.

Questions regarding this rule filing may be directed to John M. Yetter, Vice President,

The NASDAQ OMX Group, at (301) 978-8497.

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

        a.   Purpose

Phlx launched PSX in 2010 with an order execution algorithm that allocated

executions of incoming orders to orders on the PSX book based on the price and size of

posted orders, rather than price and time, with allocations made on a pro rata basis among

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[1]   15 U.S.C. 78s(b)(1).

[2]   17 CFR 240.19b-4.

orders with similar price and display characteristics.[3] In 2013, after concluding that this

pro rata model had not met the Exchange's expectations with respect to PSX's market

share, Phlx adopted a price/time model that was functionally similar to the model in place

at all other national securities exchanges.[4] Phlx is now proposing to allow its member

organizations to benefit from the advantages of each model, by adopting a system under

which some securities may trade using the current price/time model, while others may

trade under a pro rata model similar to, but in several respects different from, the model

in effect from 2010 to 2013. As described in more detail below, Phlx will select the

algorithm applicable to each security that is eligible for trading on PSX, and may change

the applicable algorithm from time to time, subject to providing advance notice to market

participants.[5]

Price/Time Algorithm

Phlx is not proposing to alter the operation of the price/time algorithm for those

securities to which it is applied, although it is modifying the applicable rule text in certain

respects to improve its clarity. Under this algorithm, the System executes trading interest

the following manner:

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[3]   Securities Exchange Act Release No. 62877 (September 9, 2010), 75 FR 56633
        (September 16, 2010) (SR-Phlx-2010-79).

[4]   Securities Exchange Act Release No. 69452 (April 25, 2013), 78 FR 25512 (May
        1, 2013) (SR-Phlx-2013-24).

[5]   The approach of allowing the applicable execution algorithm to vary on a
        security-by-security basis is currently used in the market structure of several
        options exchanges, including the NASDAQ Options Market ("NOM") (Chapter
        VI, Section 10 of the NOM Rules); the BX Options Market ("BX Options")
        (Chapter VI, Section 10 of the BX Options Rules); the Chicago Board Options
        Exchange ("CBOE") (CBOE Rule 43.1); and the C2 Options Exchange ("C2")
        (C2 Rule 6.12). It is also used in the cash equities markets at the CBOE Stock
        Exchange ("CBXS") (CBSX Rule 52.1).

- Price—Better priced trading interest is executed ahead of inferior-priced trading interest.

- Display—Displayed Quotes/Orders at a particular price are executed in time priority among such interest.

- Non-Displayed Interest—Non-Displayed Orders and the reserve portion of Quotes and Reserve Orders (collectively, "Non-Displayed Interest") at a particular price are executed in time priority among such interest.

For example, assume that sell orders with the following sizes, time stamps, and display characteristics are on the PSX book:

- Order 1: 100 shares, Non-Displayed at $9.99, 11:00.00

- Order 2: 100 shares, Non-Displayed at $10.00, 10:59.50

- Order 3: 100 shares, Displayed at $10.00, 11:00.05

- Order 4: 100 shares, Displayed at $10.00, 11:00.10

- Order 5: 100 shares, Non-Displayed at $10.00, 11:00.10

If an order to buy 400 shares at $10.00 is entered, it will execute against the resting orders in the following sequence: Order 1, since its price is superior to that of the other orders; Order 3, since as among orders priced at $10.00, it is the Displayed Order that arrived on the book first and Displayed Orders are executed ahead of Non-Displayed Interest; Order 4, since Displayed Orders are executed ahead of Non-Displayed Interest, and Order 2, since all Displayed Orders at $10.00 have been executed and as among Non-Displayed Interest at $10.00, it was the first to arrive on the book.

Pro Rata Algorithm

As noted above, the pro rata model is being altered in several respects from the version previously in effect. Most notably, for those securities for which the pro rata

model is applicable, Phlx may also opt to apply a version of the algorithm under which a

specified percentage of an execution is guaranteed to an order that establishes the best

price in PSX. This modification to the algorithm is referred to herein and in the proposed

rule as the variation for "Price-Setting Orders." As with the decision as to the applicable

algorithm, Phlx will determine whether to apply the variation to each security that trades

under the pro rata algorithm, and as described in more detail below, may change the

application from time to time, subject to providing advance notice to market participants.

Price and Displayed Orders

Under the pro rata algorithm, the System will execute trading interest within the

System in the following order:

- Price—Better priced trading interest is executed ahead of inferior-priced trading

    interest.

- Display—Displayed Orders at a particular price with a size of at least one round

    lot will be executed ahead of Displayed Orders with a size of less than one round

    lot, Non-Displayed Interest with a size of at least one round lot, Minimum

    Quantity Orders, and Non-Displayed Interest with a size of less than one round

    lot.

    o Allocation to Displayed Orders with a Size of One Round Lot or More—

        As among equally priced Displayed Orders with a size of at least one

        round lot, the System will allocate portions of incoming executable orders

        to displayed trading interest within the System pro rata based on the size

        of the Displayed Orders, rounding down to the nearest round lot. Next,

        portions of an order that would be executed in a size other than a round lot

        if they were allocated on a pro rata basis will be allocated for execution

against available displayed trading interest in the order of the original

displayed size of the remaining trading interest at that price (largest to

smallest), or, as among orders with an equal size, based on time priority.

Similarly, incoming orders with a size of less than one round lot will be

allocated against available displayed trading interest in the order of the

size of trading interest at that price (largest to smallest), or, as among

orders with an equal size, based on time priority.

For example, assume that sell orders with the following sizes, time stamps, and display

characteristics are on the PSX book:

- Order 1: 600 shares, Displayed at $10.00, 10:59.50

- Order 2: 400 shares, Displayed at $10.00, 11:00.05

- Order 3: 300 shares, Displayed at $10.00, 11:00.10

If an order to buy 1,100 shares at $10.00 is entered, it will execute against the resting

orders in the following sequence and with the following share amounts:

- Orders 1, 2, and 3: The System will make a pro rata allocation of the incoming

   order to the resting orders based on their size in round lot increments, such that

   Order 1 will be allocated 500 shares ((600 ÷ 1,300) x 1,100, rounded down to the

   nearest round lot); Order 2 will be allocated 300 shares; and Order 3 will be

   allocated 200 shares.

- Order 1: After decrementation, the remaining orders on the book each have 100

   shares, and the incoming order has 100 shares left to execute. The remaining 100

   shares of the order will be allocated to Order 1, since of the remaining resting

   orders, it was the order with the largest original displayed size.

If the incoming order was 80 shares (less than one round lot), it would be allocated to

Order 1 based on its size as the largest resting order.

Variation for Price-Setting Orders

For any security that trades under the pro rata algorithm, Phlx may adopt a

variation of the algorithm that guarantees a specified percentage allocation for an order

that sets the best price on PSX under certain conditions. The goal of the variation would

be to increase the extent to which market participants commit capital to display

significant size at a price that narrows the spread, thereby enhancing price discovery and

transparency. The "Guaranteed Percentage" for all securities subject to this variation will

be 40%.[6] A Displayed Order with a size of at least one round lot that establishes the best

price in PSX when it is entered will be a "Price-Setting Order" if such order is executed;

provided, however, that a better priced order will become the Price-Setting Order if it is

executed. The allocation to the Price-Setting Order will be the greater of the Guaranteed

Percentage or the percentage that the order would otherwise be allocated under the Pro

Rata algorithm.

By way of example, assume that Order 1 is on the PSX book to sell 1000 shares at

$10.01. If Order 2 is then entered onto the book to sell 1,000 shares at $10.00, Order 2 is

presumptively the Price-Setting Order. Assume also that Order 3 to sell 3,000 shares at

$10.00 is entered onto the book. If an incoming order to buy 1,000 at $10.00 is then

entered, 400 shares will be allocated to Order 2 based on the 40% Guaranteed Percentage

for it as the Price-Setting Order, and 600 shares will be allocated to Order 3. If, however,

before the incoming order was entered, another sell order was posted to the book at

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[6]   If Phlx determines to change the Guaranteed Percentage, it will file a proposed
        rule change to do so.

$9.99, it would have the potential to become the Price-Setting Order if it executed while still reflecting the best price in PSX. Once an order is executed as a Price-Setting Order, all previously entered orders that could have potentially been Price-Setting Orders, are no longer eligible to be Price-Setting Orders.

Displayed Odd-Lot Orders

Following the processing of Displayed Orders with a size of one round lot or more, the System will allocate remaining shares of an incoming order among equally priced Displayed Orders with a size of less than one round lot, in the order of the size of the trading interest at that price (largest to smallest), or, as among orders with an equal size, based on time priority.

Non-Displayed Interest with a Size of One Round Lot or More

As among equally priced Non-Displayed Interest with a size of at least one round lot, the System will allocate portions of incoming executable orders to Non-Displayed Interest within the System pro rata based on the size of Non-Displayed Interest, rounded down to the nearest round lot. Next, portions of an order that would be executed in a size other than a round lot if they were allocated on a pro rata basis will be allocated for execution against available Non-Displayed Interest in the order of the original size of the remaining trading interest at that price (largest to smallest), or, as among orders with an equal size, based on time priority. Similarly, incoming orders with a size of less than one round lot will be allocated against available Non-Displayed Interest in the order of the size of trading interest at that price (largest to smallest), or, as among orders with an equal size, based on time priority. Thus, the algorithm with respect to Non-Displayed Interest with a size of one round lot or more is identical to the algorithm for Displayed Orders with a size of one round lot or more.

Minimum Quantity Orders

Miminum Quantity Order are orders that will not execute unless a specified minimum quantity of shares can be obtained. Minimum Quantity Orders that post to the PSX book are not displayed, and upon entry must have a size and a minimum quantity condition of at least one round lot. In the event that the shares remaining in the size of the order following a partial execution thereof are less than the minimum quantity specified by the market participant entering the order, the minimum quantity value of the order is reduced to the number of shares remaining. Because they are non-displayed, Minimum Quantity Orders are given a lower priority of execution than Displayed Orders. Moreover, because a minimum quantity condition cannot necessarily be satisfied in a pro rata allocation system, the orders are given a lower priority than other Non-Displayed Interest with a size of one round lot or more. As among equally priced Minimum Quantity Orders, the System will allocate incoming executable orders to Minimum Quantity Orders within the System in the ascending order of the size of the minimum quantity conditions assigned to the orders. Thus, an order with a minimum quantity condition of 300 shares will be filled before an order with a minimum quantity condition of 400 shares. If there are two or more Minimum Quantity Orders with an equal minimum quantity condition, the System will determine the order of execution based on time priority.

Non-Displayed Odd-Lot Orders

As among equally priced Non-Displayed Interest with a size of less than one round lot, the System will allocate incoming orders based on the size of the Non-Displayed Interest, in the order of the size of the trading interest at that price (largest to smallest), or, as among orders with an equal size, based on time priority.

Selection of Applicable Algorithm and Notice to Member Organizations

The algorithm applicable to a particular security will be selected by the Exchange

and listed on a publicly available website. The selection will be made by the President of

the Exchange or another officer of the Exchange designated by the President for this

purpose. The selection will be based on an ongoing assessment of the depth of liquidity

made available by member organizations in particular stocks, with the goal of

maximizing the displayed size, minimizing the quoted spread, and increasing the extent

of PSX's time at the NBBO. Factors to be considered for each security would include the

size of member organizations' quotes, the amount of time that PSX is at the NBBO, PSX

market share, and observed changes in volume, average execution size, and average order

size. As a general matter, the Exchange would examine these factors and consider

adjusting the algorithm applicable to a security if it concluded that improvements in the

security's performance on PSX might result. The Exchange expects that immediately

following the implementation of this proposed rule change, most if not all securities will

trade using the pro rata algorithm, with the goal of increasing the size of displayed

liquidity in PSX, but that adjustments would then be made based on the observed

performance of the securities. For example, if a security trading under the pro rata

algorithm has large quoted size but PSX is generally not at the NBBO in the security, the

Exchange would consider moving the security to the price/time algorithm as a means of

encouraging market participants to quote more aggressively. Similarly, if PSX is at the

NBBO some of the time but to a lesser extent than the Exchange considers ideal, the

Exchange would consider adopting the variation for Price-Setting Orders as a means of

encouraging more aggressive pricing from market participants, resulting in more time at

the NBBO. The Exchange would also observe changes in PSX's market share and

volume over time to determine if the applicable algorithm had a positive or negative

effect on these metrics. In particular securities, the Exchange may also observe average

execution size and/or average order size, with the goal of increasing both metrics. The

Exchange may also conclude that if a group of similar securities (for example, certain

exchange-traded funds) trade well using a particular algorithm, other securities with the

same characteristics should also trade under that algorithm. Changes to the applicable

algorithm, including the applicability of the variation for Price-Setting Orders, would be

made through a notice that is widely disseminated at least one week in advance of the

change.

b.   Statutory Basis

Phlx believes that the proposed rule change is consistent with the provisions of

Section 6 of the Act,[7] in general, and with Section 6(b)(5) of the Act[8] in particular, in that

the proposal is designed to prevent fraudulent and manipulative acts and practices, to

promote just and equitable principles of trade, to foster cooperation and coordination with

persons engaged in regulating, clearing, settling, processing information with respect to,

and facilitating transactions in securities, 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. Specifically, Phlx believes that the proposal has

the potential to enhance the usefulness of PSX as a venue for trading cash equity

securities by allowing the Exchange to adjust the execution algorithm applicable to a

particular security to best suit its characteristics. The Exchange believes that the use of

the pro rata algorithm has the potential to encourage member organizations to display

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[7]   15 U.S.C. 78f.

[8]   15 U.S.C. 78f(b)(5).

orders with greater size in order to receive a larger share of executions. Similarly, the proposed modification to the algorithm for Price-Setting Orders has the potential to encourage market participants to set the best price on PSX. The Exchange believes that these proposals accordingly have the potential to enhance price discovery on PSX. Moreover, the Commission has previously determined that a variation of the proposed algorithm is consistent with the Act. Specifically, the Commission found that PSX's prior pro rata algorithm "may encourage participants, particularly those who wish to execute orders of large size, to display liquidity …. This in turn could facilitate the efficient execution of large orders, and foster best execution and price discovery. A novel exchange priority system that is designed to achieve these goals also may foster competition and innovation."[9] The Exchange further notes that the use of an algorithm that deemphasizes the importance of speed would provide an additional trading option to market participants that may wish to seek alternatives to the prevailing market structure for US cash equities.

In addition, the proposal is similar in several respects to rules in effect at US options exchanges. Notably, NOM and several other options exchanges, as well as the CBSX cash equities exchange, have rules that allows the applicable exchange to determine the algorithm – pro rata or price/time – applicable to each security that it trades.[10] In addition, the proposed variation to the pro rata algorithm for Price-Setting

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[9]   Securities Exchange Act Release No. 62877 (September 9, 2010), 75 FR 56633, 56635 (September 16, 2010 (SR-Phlx-2010-79).

[10]   See supra n.5. It should be noted that these rules do not specify the factors to be considered by the exchange in selecting the applicable algorithm. The Exchange understands, however, that staff of NOM and BX Options apply factors similar to the ones proposed herein in making such selections.

Orders is similar in intent to rules of numerous US options exchanges under which a

specialist is guaranteed a percentage allocation of an incoming order in consideration of

its performance of specialist obligations.[11] Similarly, the Exchange's proposal is

designed to provide a means of encouraging market participants to compete to provide

substantial liquidity at the inside market by guaranteeing them a percentage allocation.

However, unlike the guaranteed allocation for specialists, the proposed allocation would

be available to any market participant quoting in a security to which the variation

applied.[12]

        For securities not best served by a pro rata allocation, the proposal allows the

Exchange to have the flexibility to use a price/time algorithm that replicates the algorithm

in use at other national securities exchanges. The Exchange is not proposing to modify

the operation of this algorithm, which has also previously been determined to be

consistent with the Act.[13]

        The Exchange further believes that the process for determining the algorithm

applicable to a particular security is consistent with the Act's purposes of perfecting the

mechanisms of a national market system and protecting investors and the public interest.

The rule allows the Exchange to select among alternatives, most aspects of which have

already been determined by the Commission to be consistent with the Act. Moreover, by

allowing adjustments, the rule will enable the Exchange to continually evaluate data and

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[11]   See, e.g., PHLX Rule 1014(g).

[12]   The proposed rule is also similar to CBOE Rule 43.1 and CBSX Rule 52.1, which
         allow those exchanges to give priority to the market participant was first to
         establish a price (the "Market Turner"), and to retain such priority in the event the
         market moves beyond, but then returns to, the Market Turner's price.

[13]   Securities Exchange Act Release No. 69452 (April 25, 2013), 78 FR 25512 (May
         1, 2013) (SR-Phlx-2013-24).

adapt the trading of securities to changing circumstances, with the goals of increasing

displayed size and time at the inside and narrowing spreads. Finally, the Exchange

believes that the requirement to provide market participants with at least one week notice

of any change will ensure that market participants have adequate notice of changes to

enable them to make any needed adjustments to their order routing practices.

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

        Phlx does not believe that the proposed rule change will result in any burden on

competition that is not necessary or appropriate in furtherance of the purposes of the Act,

as amended.[14] Currently, PSX has minimal market share, and the Exchange believes that

the proposal may enhance its competitiveness by offering a unique market model not

currently offered by other national security exchanges. Since use of PSX is entirely

voluntary and numerous competitive alternatives exist, the change will not impose any

burden on competition. Moreover, the Exchange's prior experience with use of a pro rata

algorithm on PSX leads it to believe that although the market model would not draw

significant volume of order flow away from other trading venues, nevertheless the model

is attractive to some market participants and therefore is likely to enhance PSX's

competitiveness.

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

        Written comments were neither solicited nor received.

6.   Extension of Time Period for Commission Action

        Not applicable.

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[14]   15 U.S.C. 78f(b)(8).

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

Not applicable.

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

Although the proposed rule change is not directly based on the rules of another

self-regulatory organization, several elements of the proposal are similar to rules in effect

at other exchanges. First, NOM and several other options exchanges, as well as the

CBSX cash equities exchange, have rules that allows the applicable exchange to

determine the algorithm – pro rata or price/time – applicable to each security that it

trades.[15] Unlike the rule proposed herein, those rules do not specify the factors to be

considered by the exchange in selecting the applicable algorithm, nor do they specify the

length of notice to be provided by the applicable exchange when changing an algorithm.

The proposed variation to the pro rata algorithm for Price-Setting Orders is similar in

intent to rules of numerous US options exchanges under which a specialist is guaranteed

a percentage allocation of an incoming order in consideration of its performance of

specialist obligations.[16] Similarly, the proposal is designed to provide a means of

encouraging market participants to compete to provide substantial liquidity at the inside

market by guaranteeing them a percentage allocation. However, unlike the guaranteed

allocation for specialists, the proposed allocation would be available to any market

participant quoting in a security to which the variation applied. The proposed rule is also

similar to CBOE Rule 43.1 and CBSX Rule 52.1, which allow those exchanges to give

priority to the market participant was first to establish a price (the "Market Turner").

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[15]   See <u>supra</u> n.5.

[16]   <u>See, e.g.</u>, PHLX Rule 1014(g).

Finally, Phlx notes that the proposed rules for price/size allocation are similar to rules

previously approved by the Commission in SR-Phlx-2010-79.[17]

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

        Not applicable.

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

        Not applicable.

11.   <u>Exhibits</u>

        1. Completed notice of proposed rule change for publication in the <u>Federal

<u>Register</u>.

        5. Text of the proposed rule change.

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[17]   <u>Supra</u> n.3.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-   ; File No. SR-Phlx-2014-24)

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Notice of Filing of
Proposed Rule Change to Modify the Order Execution Alogrithm of NASDAQ OMX
PSX

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),[1] and

Rule 19b-4 thereunder,[2] notice is hereby given that on April 14, 2014, NASDAQ OMX

PHLX LLC ("Phlx" or "Exchange") filed with the Securities and Exchange Commission

("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 the Substance of the
        Proposed Rule Change

The Exchange proposes to modify the order execution algorithm of Phlx's

NASDAQ OMX PSX facility ("PSX"). The text of the proposed rule change is available

at http://nasdaqomxphlx.cchwallstreet.com/nasdaqomxphlx/phlx/, at the Exchange's

principal office, and at the Commission's Public Reference Room.

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

In its filing with the Commission, the Exchange included statements concerning

the purpose of and basis for the proposed rule change and discussed any comments it

received on the proposed rule change. The text of these statements may be examined at

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[1]   15 U.S.C. 78s(b)(1).

[2]   17 CFR 240.19b-4.

the places specified in Item IV below. The Exchange has prepared summaries, set forth

in Sections A, B, and C below, of the most significant aspects of such statements.

> A.   Self-Regulatory Organization's Statement of the Purpose of, and Statutory
>   Basis for, the Proposed Rule Change
>
> 1.   Purpose

Phlx launched PSX in 2010 with an order execution algorithm that allocated

executions of incoming orders to orders on the PSX book based on the price and size of

posted orders, rather than price and time, with allocations made on a pro rata basis among

orders with similar price and display characteristics.[3] In 2013, after concluding that this

pro rata model had not met the Exchange's expectations with respect to PSX's market

share, Phlx adopted a price/time model that was functionally similar to the model in place

at all other national securities exchanges.[4] Phlx is now proposing to allow its member

organizations to benefit from the advantages of each model, by adopting a system under

which some securities may trade using the current price/time model, while others may

trade under a pro rata model similar to, but in several respects different from, the model

in effect from 2010 to 2013. As described in more detail below, Phlx will select the

algorithm applicable to each security that is eligible for trading on PSX, and may change

the applicable algorithm from time to time, subject to providing advance notice to market

participants.[5]

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[3]   Securities Exchange Act Release No. 62877 (September 9, 2010), 75 FR 56633
       (September 16, 2010) (SR-Phlx-2010-79).

[4]   Securities Exchange Act Release No. 69452 (April 25, 2013), 78 FR 25512 (May
       1, 2013) (SR-Phlx-2013-24).

[5]   The approach of allowing the applicable execution algorithm to vary on a
       security-by-security basis is currently used in the market structure of several
       options exchanges, including the NASDAQ Options Market ("NOM") (Chapter

Price/Time Algorithm

Phlx is not proposing to alter the operation of the price/time algorithm for those securities to which it is applied, although it is modifying the applicable rule text in certain respects to improve its clarity. Under this algorithm, the System executes trading interest the following manner:

- Price—Better priced trading interest is executed ahead of inferior-priced trading interest.

- Display—Displayed Quotes/Orders at a particular price are executed in time priority among such interest.

- Non-Displayed Interest—Non-Displayed Orders and the reserve portion of Quotes and Reserve Orders (collectively, "Non-Displayed Interest") at a particular price are executed in time priority among such interest.

For example, assume that sell orders with the following sizes, time stamps, and display characteristics are on the PSX book:

- Order 1: 100 shares, Non-Displayed at $9.99, 11:00.00

- Order 2: 100 shares, Non-Displayed at $10.00, 10:59.50

- Order 3: 100 shares, Displayed at $10.00, 11:00.05

- Order 4: 100 shares, Displayed at $10.00, 11:00.10

- Order 5: 100 shares, Non-Displayed at $10.00, 11:00.10

VI, Section 10 of the NOM Rules); the BX Options Market ("BX Options") (Chapter VI, Section 10 of the BX Options Rules); the Chicago Board Options Exchange ("CBOE") (CBOE Rule 43.1); and the C2 Options Exchange ("C2") (C2 Rule 6.12). It is also used in the cash equities markets at the CBOE Stock Exchange ("CBXS") (CBSX Rule 52.1).

If an order to buy 400 shares at $10.00 is entered, it will execute against the resting orders in the following sequence: Order 1, since its price is superior to that of the other orders; Order 3, since as among orders priced at $10.00, it is the Displayed Order that arrived on the book first and Displayed Orders are executed ahead of Non-Displayed Interest; Order 4, since Displayed Orders are executed ahead of Non-Displayed Interest, and Order 2, since all Displayed Orders at $10.00 have been executed and as among Non-Displayed Interest at $10.00, it was the first to arrive on the book.

Pro Rata Algorithm

As noted above, the pro rata model is being altered in several respects from the version previously in effect. Most notably, for those securities for which the pro rata model is applicable, Phlx may also opt to apply a version of the algorithm under which a specified percentage of an execution is guaranteed to an order that establishes the best price in PSX. This modification to the algorithm is referred to herein and in the proposed rule as the variation for "Price-Setting Orders." As with the decision as to the applicable algorithm, Phlx will determine whether to apply the variation to each security that trades under the pro rata algorithm, and as described in more detail below, may change the application from time to time, subject to providing advance notice to market participants.

Price and Displayed Orders

Under the pro rata algorithm, the System will execute trading interest within the System in the following order:

- Price—Better priced trading interest is executed ahead of inferior-priced trading interest.

- Display—Displayed Orders at a particular price with a size of at least one round lot will be executed ahead of Displayed Orders with a size of less than one round lot, Non-Displayed Interest with a size of at least one round lot, Minimum Quantity Orders, and Non-Displayed Interest with a size of less than one round lot.

  o Allocation to Displayed Orders with a Size of One Round Lot or More—As among equally priced Displayed Orders with a size of at least one round lot, the System will allocate portions of incoming executable orders to displayed trading interest within the System pro rata based on the size of the Displayed Orders, rounding down to the nearest round lot. Next, portions of an order that would be executed in a size other than a round lot if they were allocated on a pro rata basis will be allocated for execution against available displayed trading interest in the order of the original displayed size of the remaining trading interest at that price (largest to smallest), or, as among orders with an equal size, based on time priority. Similarly, incoming orders with a size of less than one round lot will be allocated against available displayed trading interest in the order of the size of trading interest at that price (largest to smallest), or, as among orders with an equal size, based on time priority.

For example, assume that sell orders with the following sizes, time stamps, and display characteristics are on the PSX book:

- Order 1: 600 shares, Displayed at $10.00, 10:59.50

- Order 2: 400 shares, Displayed at $10.00, 11:00.05

- Order 3: 300 shares, Displayed at $10.00, 11:00.10

If an order to buy 1,100 shares at $10.00 is entered, it will execute against the resting

orders in the following sequence and with the following share amounts:

- Orders 1, 2, and 3: The System will make a pro rata allocation of the incoming

    order to the resting orders based on their size in round lot increments, such that

    Order 1 will be allocated 500 shares ((600 ÷ 1,300) x 1,100, rounded down to the

    nearest round lot); Order 2 will be allocated 300 shares; and Order 3 will be

    allocated 200 shares.

- Order 1: After decrementation, the remaining orders on the book each have 100

    shares, and the incoming order has 100 shares left to execute. The remaining 100

    shares of the order will be allocated to Order 1, since of the remaining resting

    orders, it was the order with the largest original displayed size.

If the incoming order was 80 shares (less than one round lot), it would be allocated to

Order 1 based on its size as the largest resting order.

Variation for Price-Setting Orders

     For any security that trades under the pro rata algorithm, Phlx may adopt a

variation of the algorithm that guarantees a specified percentage allocation for an order

that sets the best price on PSX under certain conditions. The goal of the variation would

be to increase the extent to which market participants commit capital to display

significant size at a price that narrows the spread, thereby enhancing price discovery and

transparency. The "Guaranteed Percentage" for all securities subject to this variation will

be 40%.[6] A Displayed Order with a size of at least one round lot that establishes the best

price in PSX when it is entered will be a "Price-Setting Order" if such order is executed;

provided, however, that a better priced order will become the Price-Setting Order if it is

executed. The allocation to the Price-Setting Order will be the greater of the Guaranteed

Percentage or the percentage that the order would otherwise be allocated under the Pro

Rata algorithm.

By way of example, assume that Order 1 is on the PSX book to sell 1000 shares at

$10.01. If Order 2 is then entered onto the book to sell 1,000 shares at $10.00, Order 2 is

presumptively the Price-Setting Order. Assume also that Order 3 to sell 3,000 shares at

$10.00 is entered onto the book. If an incoming order to buy 1,000 at $10.00 is then

entered, 400 shares will be allocated to Order 2 based on the 40% Guaranteed Percentage

for it as the Price-Setting Order, and 600 shares will be allocated to Order 3. If, however,

before the incoming order was entered, another sell order was posted to the book at

$9.99, it would have the potential to become the Price-Setting Order if it executed while

still reflecting the best price in PSX. Once an order is executed as a Price-Setting Order,

all previously entered orders that could have potentially been Price-Setting Orders, are no

longer eligible to be Price-Setting Orders.

Displayed Odd-Lot Orders

Following the processing of Displayed Orders with a size of one round lot or

more, the System will allocate remaining shares of an incoming order among equally

priced Displayed Orders with a size of less than one round lot, in the order of the size of

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[6]   If Phlx determines to change the Guaranteed Percentage, it will file a proposed
        rule change to do so.

the trading interest at that price (largest to smallest), or, as among orders with an equal

size, based on time priority.

Non-Displayed Interest with a Size of One Round Lot or More

As among equally priced Non-Displayed Interest with a size of at least one round

lot, the System will allocate portions of incoming executable orders to Non-Displayed

Interest within the System pro rata based on the size of Non-Displayed Interest, rounded

down to the nearest round lot. Next, portions of an order that would be executed in a size

other than a round lot if they were allocated on a pro rata basis will be allocated for

execution against available Non-Displayed Interest in the order of the original size of the

remaining trading interest at that price (largest to smallest), or, as among orders with an

equal size, based on time priority. Similarly, incoming orders with a size of less than one

round lot will be allocated against available Non-Displayed Interest in the order of the

size of trading interest at that price (largest to smallest), or, as among orders with an

equal size, based on time priority. Thus, the algorithm with respect to Non-Displayed

Interest with a size of one round lot or more is identical to the algorithm for Displayed

Orders with a size of one round lot or more.

Minimum Quantity Orders

Miminum Quantity Order are orders that will not execute unless a specified

minimum quantity of shares can be obtained. Minimum Quantity Orders that post to the

PSX book are not displayed, and upon entry must have a size and a minimum quantity

condition of at least one round lot. In the event that the shares remaining in the size of

the order following a partial execution thereof are less than the minimum quantity

specified by the market participant entering the order, the minimum quantity value of the

order is reduced to the number of shares remaining. Because they are non-displayed,

Minimum Quantity Orders are given a lower priority of execution than Displayed Orders.

Moreover, because a minimum quantity condition cannot necessarily be satisfied in a pro

rata allocation system, the orders are given a lower priority than other Non-Displayed

Interest with a size of one round lot or more. As among equally priced Minimum

Quantity Orders, the System will allocate incoming executable orders to Minimum

Quantity Orders within the System in the ascending order of the size of the minimum

quantity conditions assigned to the orders. Thus, an order with a minimum quantity

condition of 300 shares will be filled before an order with a minimum quantity condition

of 400 shares. If there are two or more Minimum Quantity Orders with an equal

minimum quantity condition, the System will determine the order of execution based on

time priority.

Non-Displayed Odd-Lot Orders

        As among equally priced Non-Displayed Interest with a size of less than one

round lot, the System will allocate incoming orders based on the size of the Non-

Displayed Interest, in the order of the size of the trading interest at that price (largest to

smallest), or, as among orders with an equal size, based on time priority.

Selection of Applicable Algorithm and Notice to Member Organizations

                The algorithm applicable to a particular security will be selected by the

Exchange and listed on a publicly available website. The selection will be made by the

President of the Exchange or another officer of the Exchange designated by the President

for this purpose. The selection will be based on an ongoing assessment of the depth of

liquidity made available by member organizations in particular stocks, with the goal of

maximizing the displayed size, minimizing the quoted spread, and increasing the extent

of PSX's time at the NBBO. Factors to be considered for each security would include the

size of member organizations' quotes, the amount of time that PSX is at the NBBO, PSX

market share, and observed changes in volume, average execution size, and average order

size. As a general matter, the Exchange would examine these factors and consider

adjusting the algorithm applicable to a security if it concluded that improvements in the

security's performance on PSX might result. The Exchange expects that immediately

following the implementation of this proposed rule change, most if not all securities will

trade using the pro rata algorithm, with the goal of increasing the size of displayed

liquidity in PSX, but that adjustments would then be made based on the observed

performance of the securities. For example, if a security trading under the pro rata

algorithm has large quoted size but PSX is generally not at the NBBO in the security, the

Exchange would consider moving the security to the price/time algorithm as a means of

encouraging market participants to quote more aggressively. Similarly, if PSX is at the

NBBO some of the time but to a lesser extent than the Exchange considers ideal, the

Exchange would consider adopting the variation for Price-Setting Orders as a means of

encouraging more aggressive pricing from market participants, resulting in more time at

the NBBO. The Exchange would also observe changes in PSX's market share and

volume over time to determine if the applicable algorithm had a positive or negative

effect on these metrics. In particular securities, the Exchange may also observe average

execution size and/or average order size, with the goal of increasing both metrics. The

Exchange may also conclude that if a group of similar securities (for example, certain

exchange-traded funds) trade well using a particular algorithm, other securities with the

same characteristics should also trade under that algorithm. Changes to the applicable

algorithm, including the applicability of the variation for Price-Setting Orders, would be

made through a notice that is widely disseminated at least one week in advance of the

change.

> 2.   Statutory Basis

Phlx believes that the proposed rule change is consistent with the provisions of

Section 6 of the Act,[7] in general, and with Section 6(b)(5) of the Act[8] in particular, in that

the proposal is designed to prevent fraudulent and manipulative acts and practices, to

promote just and equitable principles of trade, to foster cooperation and coordination with

persons engaged in regulating, clearing, settling, processing information with respect to,

and facilitating transactions in securities, 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. Specifically, Phlx believes that the proposal has

the potential to enhance the usefulness of PSX as a venue for trading cash equity

securities by allowing the Exchange to adjust the execution algorithm applicable to a

particular security to best suit its characteristics. The Exchange believes that the use of

the pro rata algorithm has the potential to encourage member organizations to display

orders with greater size in order to receive a larger share of executions. Similarly, the

proposed modification to the algorithm for Price-Setting Orders has the potential to

encourage market participants to set the best price on PSX. The Exchange believes that

these proposals accordingly have the potential to enhance price discovery on PSX.

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[7]   15 U.S.C. 78f.

[8]   15 U.S.C. 78f(b)(5).

Moreover, the Commission has previously determined that a variation of the proposed

algorithm is consistent with the Act. Specifically, the Commission found that PSX's

prior pro rata algorithm "may encourage participants, particularly those who wish to

execute orders of large size, to display liquidity …. This in turn could facilitate the

efficient execution of large orders, and foster best execution and price discovery. A novel

exchange priority system that is designed to achieve these goals also may foster

competition and innovation."[9] The Exchange further notes that the use of an algorithm

that deemphasizes the importance of speed would provide an additional trading option to

market participants that may wish to seek alternatives to the prevailing market structure

for US cash equities.

       In addition, the proposal is similar in several respects to rules in effect at US

options exchanges. Notably, NOM and several other options exchanges, as well as the

CBSX cash equities exchange, have rules that allows the applicable exchange to

determine the algorithm – pro rata or price/time – applicable to each security that it

trades.[10] In addition, the proposed variation to the pro rata algorithm for Price-Setting

Orders is similar in intent to rules of numerous US options exchanges under which a

specialist is guaranteed a percentage allocation of an incoming order in consideration of

its performance of specialist obligations.[11] Similarly, the Exchange's proposal is

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[9]   Securities Exchange Act Release No. 62877 (September 9, 2010), 75 FR 56633, 56635 (September 16, 2010 (SR-Phlx-2010-79).

[10]   See supra n.5. It should be noted that these rules do not specify the factors to be considered by the exchange in selecting the applicable algorithm. The Exchange understands, however, that staff of NOM and BX Options apply factors similar to the ones proposed herein in making such selections.

[11]   See, e.g., PHLX Rule 1014(g).

designed to provide a means of encouraging market participants to compete to provide

substantial liquidity at the inside market by guaranteeing them a percentage allocation.

However, unlike the guaranteed allocation for specialists, the proposed allocation would

be available to any market participant quoting in a security to which the variation

applied.[12]

For securities not best served by a pro rata allocation, the proposal allows the

Exchange to have the flexibility to use a price/time algorithm that replicates the algorithm

in use at other national securities exchanges. The Exchange is not proposing to modify

the operation of this algorithm, which has also previously been determined to be

consistent with the Act.[13]

The Exchange further believes that the process for determining the algorithm

applicable to a particular security is consistent with the Act's purposes of perfecting the

mechanisms of a national market system and protecting investors and the public interest.

The rule allows the Exchange to select among alternatives, most aspects of which have

already been determined by the Commission to be consistent with the Act. Moreover, by

allowing adjustments, the rule will enable the Exchange to continually evaluate data and

adapt the trading of securities to changing circumstances, with the goals of increasing

displayed size and time at the inside and narrowing spreads. Finally, the Exchange

believes that the requirement to provide market participants with at least one week notice

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[12]   The proposed rule is also similar to CBOE Rule 43.1 and CBSX Rule 52.1, which
         allow those exchanges to give priority to the market participant was first to
         establish a price (the "Market Turner"), and to retain such priority in the event the
         market moves beyond, but then returns to, the Market Turner's price.

[13]   Securities Exchange Act Release No. 69452 (April 25, 2013), 78 FR 25512 (May
         1, 2013) (SR-Phlx-2013-24).

of any change will ensure that market participants have adequate notice of changes to

enable them to make any needed adjustments to their order routing practices.

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

Phlx does not believe that the proposed rule change will result in any burden on

competition that is not necessary or appropriate in furtherance of the purposes of the Act,

as amended.[14] Currently, PSX has minimal market share, and the Exchange believes that

the proposal may enhance its competitiveness by offering a unique market model not

currently offered by other national security exchanges. Since use of PSX is entirely

voluntary and numerous competitive alternatives exist, the change will not impose any

burden on competition. Moreover, the Exchange's prior experience with use of a pro rata

algorithm on PSX leads it to believe that although the market model would not draw

significant volume of order flow away from other trading venues, nevertheless the model

is attractive to some market participants and therefore is likely to enhance PSX's

competitiveness.

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

Written comments were neither solicited nor 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

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14   15 U.S.C. 78f(b)(8).

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, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

        Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-Phlx-2014-24 on the subject line.

        Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-Phlx-2014-24. 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 on official business days between the hours of 10:00 a.m. and 3:00 p.m.

Copies of such filing also will be available for inspection and copying at the principal

offices 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-2014-24, 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.[15]

> Kevin M. O'Neill
> Deputy Secretary

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[15]   17 CFR 200.30-3(a)(12).

EXHIBIT 5

The text of the proposed rule change is below. Proposed new language is underlined; deletions are bracketed.

Rule 3307. [Book] Processing of Orders

System orders shall be executed in accordance with one of two execution algorithms: Price/Time or Pro Rata. Securities that are subject to the Pro Rata algorithm may also be subject to the variation for Price-Setting Orders described in Rule 3307(b)(2)(B). The algorithm applicable to a particular security (including the applicability of the variation for Price-Setting Orders) will be selected by the President of the Exchange or another officer of the Exchange designated by the President for this purpose, and will be listed on a publicly available website. The Exchange will notify member organizations of changes in the algorithm applicable to a particular security through a notice that is widely disseminated at least one week in advance of the change. In selecting the applicable algorithm, the Exchange will conduct ongoing assessments of the depth of liquidity made available by member organizations in particular stocks, with the goal of maximizing the displayed size, minimizing the quoted spread, and increasing the extent of PSX's time at the national best bid and best offer. Factors to be considered for each security would include the size of member organizations' quotes, the amount of time that PSX is at the national best bid and best offer, PSX's market share, and observed changes in volume, average execution size, and average order size. [through the PSX Book Process set forth below:]

(a) [Execution Algorithm -] Price/Time Execution Algorithm—Under the Price/Time execution algorithm, [T]the System shall execute [equally priced or better priced] trading interest within the System in [price/time priority in] the following order:

(1) Price—Better priced trading interest will be executed ahead of inferior-priced trading interest.

[(1)] (2) Display—Displayed Quotes/Orders at a particular price will be executed in time priority among such interest.[; and]

[(2)] (3) Non-Displayed Interest—Non-Displayed Orders and the reserve portion of Quotes and Reserve Orders (collectively, "Non-Displayed Interest") at a particular price will be executed in time priority[, in price/time priority] among such interest.

(b) Pro Rata Execution Algorithm—Under the Pro Rata Execution Algorithm, the System shall execute trading interest within the System in the following order:

(1) Price—Better priced trading interest will be executed ahead of inferior-priced trading interest.

(2) Display—Displayed Orders at a particular price with a size of at least one round lot will be executed ahead of Displayed Orders with a size of less than one round lot, Non-Displayed

Interest with a size of at least one round lot, Minimum Quantity Orders, and Non-Displayed Interest with a size of less than one round lot at the same price.

(A) Allocation to Displayed Orders with a Size of One Round Lot or More—As among equally priced Displayed Orders with a size of at least one round lot, the System will allocate round lot portions of incoming executable orders to displayed trading interest within the System pro rata based on the size of the Displayed Orders, rounding down to the nearest round lot. Next, portions of an order that would be executed in a size other than a round lot if they were allocated on a pro rata basis will be allocated for execution against available displayed trading interest in the order of the original displayed size of the remaining trading interest at that price (largest to smallest), or, as among orders with an equal size, based on time priority. Similarly, incoming orders with a size of less than one round lot will be allocated against available displayed trading interest in the order of the size of trading interest at that price (largest to smallest), or, as among orders with an equal size, based on time priority.

(B) Variation for Price-Setting Orders. The Exchange may designate a security for the variation of the Pro Rata algorithm for Price-Setting Orders. For such a security, a Displayed Order with a size of at least one round lot that establishes the best price in PSX when it is entered will be a "Price-Setting Order" if such order is executed; provided, however, that a better priced order will become the Price-Setting Order if it is executed. The allocation to the Price-Setting Order will be the greater of 40% (the "Guaranteed Percentage") or the percentage that the order would otherwise be allocated under the Pro Rata algorithm.

(3) Displayed Odd-Lot Orders—As among equally priced Displayed Orders with a size of less than one round lot, the System will allocate incoming orders against available trading interest in the order of the size of the trading interest at that price (largest to smallest), or, as among orders with an equal size, based on time priority.

(4) Non-Displayed Interest with a Size of One Round Lot or More—As among equally priced Non-Displayed Interest with a size of at least one round lot (excluding Minimum Quantity Orders), the System will allocate portions of incoming executable orders to Non-Displayed Interest within the System pro rata based on the size of Non-Displayed Interest, rounding down to the nearest round lot. Next, portions of an order that would be executed in a size other than a round lot if they were allocated on a pro rata basis will be allocated for execution against available Non-Displayed Interest in the order of the original size of the remaining trading interest at that price (largest to smallest), or, as among orders with an equal size, based on time priority. Similarly, incoming orders with a size of less than one round lot will be allocated against available Non-Displayed Interest in the order of the size of trading interest at that price (largest to smallest), or, as among orders with an equal size, based on time priority.

(5) Minimum Quantity Orders—As among equally priced Minimum Quantity Orders, the System will allocate incoming executable orders to Minimum Quantity Orders within the System in the ascending order of the size of the minimum quantity conditions assigned to the orders. Thus, an order with a minimum quantity condition of 300 shares will be filled before an order with a minimum quantity condition of 400 shares. If there are two or more Minimum Quantity

Orders with an equal minimum quantity condition, the System will determine the order of execution based on time priority.

(6) Non-Displayed Odd-Lot Orders—As among equally priced Non-Displayed Interest with a size of less than one round lot, the System will allocate incoming orders based on the size of the Non-Displayed Interest, in the order of the size of the trading interest at that price (largest to smallest), or, as among orders with an equal size, based on time priority.

[(3)](c) Exception: Anti-Internalization—As an exception to both algorithms, [M]market participants may direct that Quotes/Orders entered into the System not execute against Quotes/Orders entered under the same MPID. In addition, market participants using the OUCH order entry protocol may assign to orders entered through a specific order entry port a unique group identification modifier that will prevent Quotes/Orders with such modifier from executing against each other. In such a case, a market participant may elect from the following options:

(A) if the interacting Quotes/Orders are equivalent in size, both Quotes/Orders will be cancelled back to their entering parties. If the interacting Quotes/Orders are not equivalent in size, share amounts equal to the size of the smaller of the two Quotes/Orders will be cancelled back to their originating parties with the remainder of the larger Quote/Order being retained by the System for potential execution;

(B) regardless of the size of the interacting Quotes/Orders, cancelling the oldest of them in full; or

(C) regardless of the size of the interacting Quotes/Orders, cancelling the most recent of them in full.

The foregoing options may be applied to all orders entered under the same MPID, or, in the case of market participants using the OUCH order entry protocol, may be applied to all orders entered through a specific order entry port.

[(b)](d) Decrementation—Upon execution, an order shall be reduced by an amount equal to the size of that execution.

[(c)] (e) Price Improvement—Any potential price improvement resulting from an execution in the System shall accrue to the taker of liquidity.
Example:
Buy order resides on book at 10.
Incoming order to sell priced at 9 comes into the System
Order executes at 10 (seller get $1 price improvement)