

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

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

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

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

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

**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 *	Angela	Last Name *	Saccomandi Dunn
Title *	Principal Associate General Counsel		
E-mail *	angela.dunn@nasdaq.com		
Telephone *	(215) 496-5692	Fax	<input type="text"/>

**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	02/15/2017	Executive Vice President and General Counsel
By	Edward S. Knight	<input type="text"/>

(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.

edward.knight@nasdaq.com

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) Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> NASDAQ PHLX LLC (“Phlx” or “Exchange”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposal to amend Rule 501 (Specialist Appointment), Rule 507 (Application for Approval as an SQT, RSQT, or RSQTO and Assignment in Options), Rule 508 (Transfer Application), Rule 510 (SQT and RSQT Performance Evaluation), and Rule 511 (Specialist Allocation and Performance Evaluation).<sup>3</sup> The proposed amendments are described further below. This Amendment No. 1 supersedes the original filing in its entirety.

A notice of the proposed rule change for publication in the Federal Register is attached as Exhibit 1 and a copy of applicable portion of the Exchange’s rules 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 the Exchange (the “Board”) on May 3, 2016. No other action by the Exchange is necessary for the filing of the rule change.

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

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

<sup>3</sup> References to rules are to Phlx rules unless otherwise noted. The terms SQT, RSQT, RSQTO, and Specialist are discussed below.

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

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

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

a. Purpose

The Exchange proposes to amend: (1) Rule 501 to delete a reference to a back-up specialist; (2) Rule 507 to: update the reference to “Board” to permit the Board to appoint a panel; update the composition of the review committee; and update the reference to Rule 510; (3) Rule 508 to delete the reference to “lease” and the cross-reference to Rule 511; (4) Rule 510 to re-entitle the rule “Good Standing for Specialist, SQT, and RSQT,”<sup>4</sup> and add relevant good standing language, and appeal rights; and (5) Rule 511 to delete the rule.

Rules 501, 507, 508, 510, and 511 are part of the 500 series of rules in the Rules of the Exchange (the “Series 500 Rules”), which are entitled “Allocation, SQT, RSQT, and Evaluation Rules (Rule 500 - 599).”<sup>5</sup> Many Series 500 Rules were established more than three decades ago with the advent of options trading on the Exchange,<sup>6</sup> at which

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<sup>4</sup> “Specialist” is an Exchange member who is registered as an options specialist pursuant to Rule 1020(a). “Remote Specialist” is a specialist that does not have a physical presence on the floor of the Exchange. Streaming quote trader (“SQT”) and remote streaming quote trader (“RSQT”) are electronic traders on the Exchange pursuant to Rule 1014(b)(ii)(A) and Rule 1014(b)(ii)(B), respectively.

<sup>5</sup> These Series 500 Rules apply to Exchange members that trade options. The Exchange continues to have a hybrid options floor, but no longer has an equities floor or a commodities floor.

<sup>6</sup> For example, Rules 501, 505, and 506, were adopted on a pilot basis in 1982. See Securities Exchange Act Release No. 18975 (August 17, 1982), 47 FR 37019

time Exchange options trading was strictly on-floor open outcry through specialists. Exchange options trading has, since that time, developed into a robust hybrid system that is currently largely electronic and off-floor<sup>7</sup> but continues to have an on-floor specialist<sup>8</sup> and an open outcry trading floor. The Exchange is now updating and modernizing the Series 500 Rules as discussed below.<sup>9</sup>

#### Updating Rule 501

The Exchange proposes in Rule 501 to delete the reference to a back-up specialist.

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(August 24, 1982) (approval order regarding pilot in respect of Rules 501-506 and authorizing the Phlx Allocation, Evaluation and Securities Committee, which no longer exists). See also Securities Exchange Act Release No. 18975 (August 17, 1982), 47 FR 37019 (August 24, 1982) (SR-Phlx-81-1) (approval order regarding Rules 100, 201, 203 and 214 in combination with Rules 500 through 505). Rules 500, 501, 505, 506, 508, 511, 515, 520, 522, 523, 525, and 526 (of which Rules 500, 515, 516, 520, 522, 523, 525, and 526 no longer exist) were permanently approved in 1991. See Securities Exchange Act Release No. 29369 (June 26, 1991), 56 FR 30604 (July 3, 1991) (SR-Phlx-87-42) (order granting permanent approval). Rule 507 was adopted in 2004. See Securities Exchange Act Release No. 50100 (July 27, 2004), 69 FR 46612 (August 3, 2004) (SR-Phlx-2003-59) (order granting approval). Rule 510 was adopted in 2007. See Securities Exchange Act Release No. 55080 (January 10, 2007), 72 FR 2324 (January 18, 2007) (SR-Phlx-2006-51) (order granting approval). The Exchange has filed a separate proposal regarding two of the rules in the Series 500 Rules, namely Rules 505 and 506. See Securities Exchange Act Release No. 77121 (February 11, 2016), 81 FR 8308 (February 18, 2016) (SR-Phlx-2016-22) (notice of filing and immediate effectiveness to delete Rule 505 and update Rule 506).

<sup>7</sup> Electronic traders include Registered Options Traders or “ROTs,” that are Streaming Quote Traders or “SQTs”, Remote Streaming Quote Traders or “RSQTs,” as well as off-floor specialists (Remote Specialists) (collectively “market makers”). See Rules 1014(b)(ii)(A), 1014(b)(ii)(B), and 1020.

<sup>8</sup> Unlike specialists, Remote Specialists do not have a physical presence on the floor of the Exchange. Rule 1020.

<sup>9</sup> While the vast majority of options-related rules are found in Rule 1000 and higher (with option index rules found in Rule 1000A and higher), some of the older options-related rules are, as discussed, in the Series 500 Rules.

Currently, Rule 501 states that initial application(s) to become a specialist unit shall include information regarding the specialist, back-up specialist unit and a substitute specialist unit. With the development of liquidity-enhancing electronic market makers on the Exchange such as RSQs, which make markets in the same options issues as specialists, and the diminution of the role that the specialist plays in managing the order book on the Exchange, both a back-up specialist and substitute specialist are no longer needed.<sup>10</sup> Therefore, obsolete language in Rule 501 in respect of back-up specialists, which includes Commentary .01 to Rule 501, is proposed to be deleted from Rule 501. All of the other initial application requirements of Rule 501, which include the following information, remain unchanged: the identity of the individual who will act as head specialist and as assistant specialist(s) in the unit; the identity of the unit's staff positions and who will occupy those positions; the identity of a substitute specialist unit not associated with the specialist unit, which shall serve as a substitute specialist unit in the event that the specialist unit is unable to perform the duties of a specialist; the unit's clearing arrangements; and the unit's capital structure, including any lines of credit.<sup>11</sup>

#### Updating Rule 507

The Exchange proposes in Rule 507 to update the reference to "Board," update the composition of the review committee, and update the reference to Rule 510.

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<sup>10</sup> The function of a back-up specialist unit not associated with the specialist unit, as in current Rule 501(b), is for one specialist unit on the floor to provide staffing when needed to another specialist unit on the floor. Because multiple specialist units are no longer present on the floor, the back-up function is no longer feasible. Moreover, as discussed below, the specialist unit must clearly indicate its staffing to the Exchange, and the substitute specialist requirement continues unchanged.

<sup>11</sup> Rule 501(a) and (b).

First, Rule 507(a) currently states that the Board has the ability to perform functions such as deferring or limiting approval of SQTs or RSQTs. The Exchange proposes to replace the role of the Board with Exchange staff. The Exchange may therefore defer, for a period to be determined in the Exchange's discretion, approval of qualifying applications for SQT or RSQT status pending any action required to address the issue of concern to the Exchange. The Exchange's Membership department<sup>12</sup> may not defer a determination of the approval of the application of any SQT or RSQT applicant or place any limitation(s) on access to the Exchange's electronic quoting and trading system on any SQT or RSQT applicant unless the basis for such limitation(s) or deferral have been objectively determined by the Exchange, subject to Securities and Exchange Commission approval or effectiveness pursuant to a rule change filing under Section 19(b) of the Securities Exchange Act of 1934, as amended. The Exchange shall provide written notification to any SQT or RSQT applicant whose application is the subject of such limitation(s) or deferral, describing the objective basis for such limitation(s) or deferral. The Exchange believes that this change will help with the administration and application of Rule 507. Also, there is an appeal to the Board from any action of Exchange staff within Rule 507(e).

Second, Rule 507(e) currently states that an appeal to the Board from a decision of the Exchange regarding an SQT, RSQT, or RSQTO<sup>13</sup> application may be requested by a member or member organization; and that such appeal shall be heard by a special

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<sup>12</sup> Applications for SQTs and RSQTs would be reviewed by the Membership department. Today, the Exchange's Membership Department review applications for membership to Phlx for both equities and options members.

<sup>13</sup> "RSQTO" is a Remote Streaming Quote Trader Organization with up to five affiliated RSQTs. Rule 507(a).

committee of the Board composed of three (3) Directors, at least one of whom will be Independent. In light of and commensurate with the first proposed Rule 507 change regarding the Board, the Exchange proposes to state that any appeal from a decision pursuant to Rule 507 may be heard by the Board or a panel appointed by the Board (“Board Panel”) composed of three (3) members not involved in the Exchange decision appealed from and who otherwise have no conflict of interest;<sup>14</sup> and that, as now, there

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<sup>14</sup> The language stating that one of the Board members shall be an Independent is proposed to be deleted. The Exchange believes that this is proper as the “Independent” label is now a distinction with little, if any, effect. Whereas the vast majority of Phlx Board members were not Independent when Rule 507 was put into place and the Exchange was a membership corporation, and application of the Independent label may have made sense under those circumstances, the composition of the Phlx Board has radically changed since Phlx became a subsidiary of a public company, Nasdaq, Inc., in 2008. The By-Laws of the Exchange now provide that the Exchange may have Public Directors, Non-Industry Directors, and Industry Directors; and that Industry Directors may include no more than two officers of the Exchange, selected at the sole discretion of the Board, which may serve in the role of Staff Director (not Independent). Phlx By-Laws Article I. See also Securities Exchange Act Release No. 77165 (February 17, 2016), 81 FR 9041 (February 23, 2016) (SR-BSECC-2015-002; SR-SCCP-2015-02; SR-BX-2015-085; SR-NASDAQ-2015-160; SR-Phlx-2015-113) (order granting approval). Now, all but one of the twelve members on the Phlx Board are Independent (the only exception being one Staff Board member who is an officer of the Exchange). Thus, in light of the composition of the Phlx Board, which has one Staff Board member, only one of the three Directors on the special committee discussed in current Rule 507 could even possibly be not Independent; and, by Phlx By-Laws no more than two Directors could ever be not Independent. The Exchange believes that, distinct from the Independent criteria, the ability of the Board to appoint a panel as proposed will serve to enhance the ability to quickly assemble a panel in case of potential appeal, if one occurs. The Exchange notes that a special committee per Rule 507 has not been instituted since, let alone before, Phlx became a subsidiary of Nasdaq, Inc. The Exchange also notes that the compositional requirements for the Boards that oversee the three options markets under the umbrella of Nasdaq, Inc. (Phlx, The NASDAQ Options Market LLC (“NOM”), and NASDAQ BX, Inc. (“BX Options”)) are similar. While there is no requirement in this proposal for an Independent panel member to be appointed to the Board Panel, the Exchange notes that the public member has some independent aspect. See Phlx By-Laws at Article I (hh), “The term ‘public member’ means a member of any committee appointed by the Board



shall be no appeal to the Board from a decision of the Board Panel. If a Board Panel is appointed by the Board, three persons shall be selected to serve on the Board Panel and in making such selections the Board shall choose individuals whose background, experience and training qualify them to consider and make determinations regarding the subject matter to be presented to the Board Panel. The Exchange notes that references to “special committee” will now refer to “Board” or “Board Panel” with this proposal. The Board Panel shall consist of two members of the Exchange, or general partners or officers of member organizations and one other person that would qualify as a public member as defined in Article I of the By-Laws, whom the Board considers to be qualified.

Third, Rule 507(b) currently states that, when making a decision concerning an application for assignment in an option, the Exchange shall consider the applicant’s prior performance as a specialist, SQT, or RSQT based on evaluations conducted pursuant to Exchange Rule 510.<sup>15</sup> The Exchange is, as discussed below, proposing to update Rule 510 so that in lieu of the current formulaic language in the rule, there is new language that accentuates the good standing of members. In light of this, the Exchange proposes to update the 507(b) reference to state that the Exchange can consider the applicant’s prior performance as a specialist, SQT or RSQT based on “good standing pursuant to Rule 510.” The Exchange is not proposing any other change to Rule 507. The Exchange notes

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of Directors who has no material business relationship with a broker or dealer, the Exchange, or its affiliates.”

<sup>15</sup> Other factors for consideration include: (A) the financial and technical resources available to the applicant; and (B) the applicant’s experience and expertise in market making or options trading. Rule 507(b).

that the other aspects of Rule 507, such as, for example, RSQTO eligibility criteria,<sup>16</sup> SQT and RSQT eligibility criteria,<sup>17</sup> and technological ability for RSQTOs, SQTs, or RSQTs,<sup>18</sup> remain in place.<sup>19</sup>

#### Updating Rule 508

The Exchange proposes in Rule 508 to delete the reference to “lease” and to Rule 511.

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<sup>16</sup> These RSQTO criteria include: (A) Significant market-making and/or specialist experience in a broad array of securities; (B) Superior resources, including capital, technology and personnel; (C) Demonstrated history of stability, superior electronic capacity, and superior operational capacity; (D) Proven ability to interact with order flow in all types of markets; (E) Existence of order flow commitments; (F) Willingness to accept allocations as an RSQT in options overlying 400 or more securities; and (G) Willingness and ability to make competitive markets on the Exchange and otherwise to promote the Exchange in a manner that is likely to enhance the ability of the Exchange to compete successfully for order flow in the options it trades. Rule 507(a)(i).

<sup>17</sup> These SQT and RSQT criteria include: (A) Significant market-making and/or specialist experience in a broad array of securities; (B) Superior resources, including capital, technology and personnel; (C) Demonstrated history of stability, superior electronic capacity, and superior operational capacity; (D) Proven ability to interact with order flow in all types of markets; (E) Willingness and ability to make competitive markets on the Exchange and otherwise to promote the Exchange in a manner that is likely to enhance the ability of the Exchange to compete successfully for order flow in the options it trades; (F) A current affiliation with an Exchange-approved RSQTO (RSQT applicants only). Rule 507(a)(ii).

<sup>18</sup> No application for initial assignment in an option shall be approved without verification that (A) the RSQTO, SQT or RSQT applicant has sufficient technological ability to support his/her continuous quoting requirements as set forth in Rule 1014(b)(ii), and (B) the RSQTO, SQT or RSQT applicant has successfully completed, or is scheduled to complete, testing of its quoting system with the Exchange. Rule 507(b)(ii).

<sup>19</sup> Specialist (and Remote Specialist) eligibility and qualification requirements are discussed in Rules 501, 506, 1014, and 1020.

First, Rule 508 currently refers to “lease.” Leasing is no longer practiced on the Exchange, and for this reason the Exchange is proposing to delete this obsolete term from Rule 508. This is similar to a recent proposal wherein the Exchange noted that leasing is an obsolete term that should be deleted.<sup>20</sup>

Second, Rule 508 currently refers to Rule 511, regarding specialists. The Exchange proposes to delete the Rule 508 reference to Rule 511. This is because, as discussed below, Rule 511 is proposed to be deleted as the language of Rule 510 is proposed to be modified to include specialists.<sup>21</sup>

#### Updating Rule 510

The Exchange proposes to entitle Rule 510 “Good Standing for Specialist, SQT, and RSQT” and to add relevant good standing language.

First, Rule 510 currently applies only to SQTs and RSQTs. The Exchange proposes to change the language of Rule 510 to indicate that this rule will also be applicable to specialists. Thus, the Exchange proposes to entitle Rule 510 as “Good Standing for Specialist, SQT, and RSQT.” The good standing requirement, which is discussed below, is a continuous requirement rather than a periodic evaluation requirement as in current Rules 510 and 511.<sup>22</sup> The requirements to remain in good

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<sup>20</sup> See Securities Exchange Act Release No. 77121 (February 11, 2016), 81 FR 8308 (February 18, 2016) (SR-Phlx-2016-22) (notice of filing and immediate effectiveness to delete Rule 505 and update Rule 506).

<sup>21</sup> Rule 508 will continue to indicate, without reference to Rule 511, that failure to provide the Exchange prior notice of a transfer in accordance with Rule 508, or failure to obtain Exchange approval of a transfer, permits the Exchange to recover the allocated securities and reallocate them pursuant to Rule 506.

<sup>22</sup> Proposed Rule 510, which applies to specialists (including Remote Specialists), SQTs, and RSQTs, discusses that good standing on the Exchange means continuous compliance with, among other things, Exchange options rules and

standing are discussed in the new language in Rule 510(a). These obligations will be continuous and not periodic. The Exchange will provide written notice to a specialist (including Remote Specialist), SQT, or RSQT of a contemplated action regarding good standing pursuant to Rule 510, as noted below. A specialist (including Remote Specialist), SQT, or RSQT may request and the Exchange may hold an informal meeting to discuss the alleged failure to remain in good standing and to explore possible appropriate remedies. Written notice of the date and time of the meeting will be given to the specialist (including Remote Specialist), SQT, or RSQT and no verbatim record will be kept. If the Exchange believes there are no mitigating circumstances that would demonstrate substantial improvement of or reasonable justification for the failure to meet the good standing requirements of this Rule 510, the Exchange may take appropriate action pursuant to subsection (b) of this Rule 510. This process is described in further detail below. Exchange staff will evaluate good standing which entails continuous compliance with, among other things, Exchange options rules and procedures as well as market making requirements (market making requirements are found in Rule 1014).

Second, Rule 510 currently is written in terms of doing performance evaluations for SQTs and RSQTs. Currently, Rule 507 has a very detailed process for applying for and approving SQTs and RSQTs, and for assigning options to SQTs and RSQTs. In addition, today Rule 501 defines the application and approval process for specialists.<sup>23</sup>

To more closely align the Exchange with another options exchange, namely BX Options,

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procedures as well as market making requirements (market making requirements are found in Rule 1014). In light of the proposed continuous and extensive good standing requirements per Rule 510 as well as other rule requirements, the old evaluations applicable to SQTs, RSQTs, and specialists are not needed.

<sup>23</sup> Rules 506, 508, and 513 discuss other aspects of the process.

the Exchange is adopting language similar to BX Options Rule at Chapter VII, Section 4 (the “BX Options rule”).<sup>24</sup> Similar to Phlx, BX Options has market makers (“BX Options Market Makers”, which are also known as lead market makers (“LMMs”)). All BX Options Market Makers are designated as specialists on BX for all purposes under the Act or rules thereunder.<sup>25</sup> The Exchange is adopting the BX Options rule and proposing, in lieu of the current formulaic language in Rule 510, to insert new language indicating how a member of the Exchange can remain in good standing on the Exchange. The Exchange believes that this new proposal will obligate market participants that conduct market making activities with continuous requirements to remain in good standing as compared to periodic requirements. The continuous requirements will serve to

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<sup>24</sup> See Securities Exchange Act Release No. 67256 (June 26, 2012), 77 FR 39277 (July 2, 2012) (order approving establishment of BX Options and marketplace rules) (SR-BX-2012-030).

<sup>25</sup> See BX Options Chapter VII, Section 2.

For obligations of BX Options Market Makers, see BX Options Chapter VII, Section 5, entitled “Obligations of Market Makers.” This section indicates that BX Options Markets Maker obligations include, but are not limited to: maintain a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market in transactions where acting in a market making capacity; not make bids or offers or enter into transactions that are inconsistent with such course of dealings; maintain a two-sided market, during trading hours, in those options in which the Market Maker is registered to trade, in a manner that enhances the depth, liquidity and competitiveness of the market; compete with other Market Makers in all options in which the Market Maker is registered to trade; update quotations in response to changed market conditions in all options in which the Market Maker is registered to trade; and maintain active markets in all options in which the Market Maker is registered.

The BX Options Market Maker obligations are similar in nature to those of Phlx specialists, which can be found in Phlx Rule 1014, entitled “Obligations and Restrictions Applicable to Specialists and Registered Options Traders,” and include: maintain a fair and orderly market; not enter into transactions or make bids or offers that are inconsistent with such a course of dealings; quote a two-sided market; and maintain a two-sided market.

accentuate the good standing of members who have remained in compliance. The Exchange believes that it is important for market structure for these participants to have continuous requirements to remain in good standing rather than only periodic evaluations.

The proposed new language is similar, in all material respects,<sup>26</sup> to BX Options rule at Chapter VII, Section 4. Specifically, the Exchange proposes to adopt new language in Rule 510(a) to state that to remain in good standing as a specialist (including Remote Specialist), SQT, or RSQT, the specialist, SQT, or RSQT must:

- (i) continue to meet the requirements established in SEC Rule 15c3-1(a)(6)(i),<sup>27</sup> and the requirements set forth in the Series 500 Rules in the Rules of the Exchange;
- (ii) continue to satisfy the specialist, SQT or RSQT qualification and market making requirements specified by the Exchange, as amended from time to time;
- (iii) comply with the Rules of the Exchange and the Options Rules<sup>28</sup> as well as the rules of The Options Clearing Corporation (“OCC”) and the rules of the Federal Reserve Board “FRB”); and

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<sup>26</sup> As with virtually all rules text copied from another exchange, changes are made to the proposed rule text to better fit the structure of the existing rules of the Exchange.

<sup>27</sup> SEC Rule 15c-3, 240 CFR 15c3-1, is the net capital requirement for brokers or dealers.

<sup>28</sup> As discussed, while the vast majority of options-related rules are found in Rule 1000 and higher (with option index rules in Rule 1000A and higher), some of the older options-related rules are found in rules below 1000, such as, for example, the Series 500 Rules.

- (iv) pay on a timely basis such member, transaction and other fees as the Exchange shall prescribe.<sup>29</sup>

These proposed requirements to remain in good standing on the Exchange are not periodic, as are the evaluation and performance concepts in current Rules 510 and 511, but rather are continuous in nature.

Third, the Exchange notes that with the proposed new good standing requirements, specialist and other market maker (e.g., RSQT) obligations, such as market making, will continue to apply.<sup>30</sup> For specialists (and RSQTs functioning as Remote Specialists) the Rule 1014 market making obligations are applicable throughout the trading day. Thus, a specialist (or Remote Specialist) shall continue to be responsible to quote two-sided markets in the lesser of 99% of the series or 100% of the series minus one call-put pair in each option in which such specialist is assigned. To satisfy this requirement with respect to quoting a series, the specialist must quote such series 90% of the trading day (as a percentage of the total number of minutes in such trading day) or such higher percentage as the Exchange may announce in advance. These obligations will apply collectively to all appointed issues of the specialist, rather than on an issue-by-issue basis. Compliance with this obligation will be determined on a monthly basis. However, determining compliance with the continuous quoting requirement on a monthly basis does not relieve the specialist (including the Remote Specialist) of the obligation to provide continuous two-sided quotes on a daily basis, nor will it prohibit the Exchange

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<sup>29</sup> Member assessments are generally reflected in the Phlx Pricing Schedule.

<sup>30</sup> Other obligations include, for example: order exposure, order handling, and best execution.

from taking disciplinary action against the specialist (including the Remote Specialist) for failing to meet the continuous quoting obligation each trading day.<sup>31</sup>

Fourth, the proposed new language in Rule 510(b) states that the good standing of a specialist (including Remote Specialist), SQT, or RSQT may be suspended, terminated or otherwise withdrawn, as provided in the Exchange's rules, if any of these conditions for approval cease to be maintained or the specialist, SQT, or RSQT violates any of its agreements with the Exchange or any of the provisions of the Rules of the Exchange or of the Options Rules. The Exchange is proposing to add an Informal Meeting process and appeal rights, which do not exist in Rule 510 for specialists at this time.

The Informal Meeting process proposed in Rule 510 is based on the Informal Meeting process in current Rules 510 (for SQTs and RSQTs) and 511 (for specialists), which is in respect of performance evaluations. The Informal Meeting process proposed in Rule 510 is, however, in respect of good standing. Specifically, the Exchange proposes to amend Rule 510 to adopt the following language in Rule 510(b)(i): The Exchange will provide written notice to a specialist (including Remote Specialist), SQT, or RSQT of a contemplated action regarding good standing pursuant to this Rule 510. A specialist (including Remote Specialist), SQT, or RSQT may request and the Exchange

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<sup>31</sup> See Rule 1014(b)(ii)(D)(2).

For the market making obligations of SQTs and RSQTs (including Directed SQT or DRSQTs, and Directed RSQTs or DRSQTs), which remain unchanged, see Rule 1014(b)(ii)(D)(1). This rule states that, like for specialists, compliance for SQTs and RSQTs will be determined on a monthly basis. However, determining compliance with the continuous quoting requirement on a monthly basis does not relieve an SQT, RSQT, DSQT, or DRSQT of the obligation to provide continuous two-sided quotes on a daily basis, nor will it prohibit the Exchange from taking disciplinary action against an SQT, RSQT, DSQT, or DRSQT for failing to meet the continuous quoting obligation each trading day. Rule 1014(b)(ii)(D)(1).



may hold an informal meeting to discuss the alleged failure to remain in good standing and to explore possible appropriate remedies. Written notice of the date and time of the meeting will be given to the specialist (including Remote Specialist), SQT, or RSQT and no verbatim record will be kept. If the Exchange believes there are no mitigating circumstances that would demonstrate substantial improvement of or reasonable justification for the failure to meet the good standing requirements of this Rule 510, the Exchange may take appropriate action pursuant to subsection (b) of this Rule 510.

Nothing in this Informal Meeting process limits the Exchange from enforcing the rules of the Exchange, which may include a disciplinary action pursuant to such rules. The Regulatory staff may, for example, initiate a disciplinary action pursuant to Rule 960.3 against a member for failure to meet continuous quoting obligations in Rule 1014.<sup>32</sup> The proposed appeal rights in Rule 510(c) are taken from current Rule 511, but expanded to cover specialists (including Remote Specialists), SQTs, and RSQTs.<sup>33</sup> Specifically, the Exchange proposes to amend Rule 510 to adopt the following language in Rule 510(c):  
An appeal by a specialist (including Remote Specialist), SQT, or RSQT to the Board of Directors from a decision of the Exchange may be requested by a member or member

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<sup>32</sup> Specifically, the Exchange may pursue disciplinary process against a member that commits an egregious market making violation evidenced by a pattern of repeated failure to make a two-sided market in assigned options.

<sup>33</sup> The SQT and RSQT appeal rights to the Board currently in Rule 510 are limited to apply only in respect of performance evaluations. The Exchange believes that the appeal rights afforded SQTs and RSQTs in proposed Rule 510, which will be to the Board or a Board Panel, are appropriate in that they are expanded to cover any decision of the Exchange regarding Rule 510; and, an informal meeting process is also afforded prior to appeal. The Board or a Board Panel would serve as a secondary appeal to a group of individuals that were not involved in the primary decision making. The Exchange is seeking to afford its members due process when seeking an appeal.

organization interested therein by filing with the Secretary of the Exchange written notice of appeal within ten (10) days after the decision has been rendered. Any appeal from a decision pursuant to Rule 510 may be heard by the Board or a Board Panel composed of three (3) members not involved in the Exchange decision appealed from and who otherwise have no conflict of interest.<sup>34</sup> If a Board Panel is appointed by the Board, three persons shall be selected to serve on the Board Panel and in making such selections the Board shall choose individuals whose background, experience and training qualify them to consider and make determinations regarding the subject matter to be presented to the Board Panel. The Board Panel shall consist of two members of the Exchange, or general partners or officers of member organizations and one other person who would qualify as a public member as defined in Article I of the By-Laws, whom the Board considers to be qualified. The person requesting review shall be permitted to submit a written statement to and/or appear before the Board or Board Panel. The Secretary of the Exchange shall certify the record of the proceeding, if any, and the written decision, and shall submit these documents to the Board or Board Panel. The Board's or Board Panel's review of the action shall be based solely on the record, the written decision and any statement submitted by the person requesting the review. The Board or Board Panel shall prepare and deliver to such person a written decision and reasons therefore. If the Board or Board Panel affirms the action, the action shall become effective ten (10) days from the

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<sup>34</sup> Rule 511(f) now states, in relevant part, that any appeal from a decision pursuant to Rule 511 regarding evaluation or review shall be heard by a special committee of the Board of Directors composed of three (3) Directors, of whom at least one (1) shall be an Independent. The Exchange believes that, as discussed, the old independence requirement is no longer needed when Rule 510 is restructured. Commensurate with other proposed changes discussed herein, Rule 510 appeals can be heard by the Board or a Board Panel.

date of the Board Panel's decision. There shall be no appeal to the Board from any decision of the Board Panel.<sup>35</sup>

The memorialization of appeal rights in proposed Rule 510(c) is done to ensure that if the good standing of a specialist, SQT, or RSQT is suspended, terminated or otherwise withdrawn then they have a clear way to initiate and prosecute an appeal regarding such decision. The proposed due process methodology is similar to other rules of the Exchange. By proposing new language in Rule 510(a) and (b) regarding specialists, SQTs, and RSQTs regarding good standing, which is similar to that of BX Options, the continuous good standing rules of the Exchange and BX Options will be more aligned and easier to apply. Proposed Rule 510 describes an Informal Meeting process and appeal rights applicable to specialists (including Remote Specialists), SQTs, and RSQTs. The Exchange is replacing the current *periodic* evaluation or performance requirements in Rule 510 (e.g., monthly for SQTs and RSQTs), as also in Rule 511 (e.g., annually for specialists) as discussed, with the proposed Rule 510 *continuous* requirements for specialists (including Remote Specialists), SQTs, and RSQTs to meet Exchange, Commission, OCC and FRB rules and requirements to remain in good standing. Compliance with good standing requirements is monitored across the Exchange.<sup>36</sup>

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<sup>35</sup> The appeal process in proposed Rule 507(e) is amended to reflect an appeal to the Board or a Board Panel.

<sup>36</sup> Thus, in Rule 510 the Exchange is proposing an Informal Meeting process and appeal rights applicable to specialists (including Remote Specialists), SQTs, and RSQTs. And, the Exchange is replacing the current *periodic* evaluation or performance requirements in Rule 510 (e.g., monthly for SQTs and RSQTs), as also in Rule 511 (e.g., annually for specialists) as discussed, with the proposed Rule 510 *continuous* requirements for specialists (including Remote Specialists), SQTs, and RSQTs to meet Exchange, Commission, OCC and FRB rules and

### Deleting Rule 511

The Exchange has concluded that, with the placement of the good standing concepts into proposed Rule 510 in such a way that they include specialist (and Remote Specialist), Rule 511 is no longer needed. In Rule 510, as discussed, in lieu of the current language, the Exchange is proposing to adopt new language indicating how a member of the Exchange can remain in good standing.

The proposed new language in Rule 510 is, in all material respects, similar to the BX Options rule at Chapter VII, Section 4. Because of this proposed new language in Rule 510, which addresses specialists (as also Remote Specialists, RSQTs, and SQTs), the Exchange proposes to delete Rule 511 in its entirety. The Exchange believes that, within the effort to update and consolidate the Series 500 Rules as discussed, it is reasonable and proper to delete Rule 511. This rule was established decades ago for the purpose of dealing with the extensive on-floor open outcry specialist system, with multiple competing specialist units. Since the implementation of Rule 511, the open outcry options floor has evolved into a robust and competitive principally electronic system, and the remaining hybrid options floor does not have numerous competing specialists as was the case when Rule 511 was instituted.

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requirements to remain in good standing. Compliance with good standing requirements is monitored across the Exchange. Thus, for example, units that monitor the application, allocation, and fees requirements and processes include membership, listing, and finance groups. And the surveillance group will continue to use its current processes to monitor compliance with Exchange rules and where appropriate will pursue disciplinary action against members for rule violations(s) (e.g., failure to make two-sided market(s) per Phlx Rule 1014). Moreover, while proposed Rule 510 is being changed the market making and other obligations for specialists, SQTs, and RSQTs continue as discussed.

The Exchange believes that under the circumstances, and because specialists are proposed to be covered in Rule 510 in terms of good standing, and continue to be covered in the Series 500 Rules and other rules of the Exchange,<sup>37</sup> deletion of Rule 511 is proper.

As discussed, the Exchange is deleting the performance evaluation structure of Rule 511 and is proposing to relocate the concept within Rule 510 with the proposed good standing requirement and appeal rights applicable to specialists, SQTs, and RSQTs. The Exchange believes that the proposed good standing approach, which is applicable to specialists, SQTs, and RSQTs, enhances the current rule because unlike the periodic nature of the performance evaluation structure the proposed good standing approach would have continuous requirements that must be maintained in order to remain in good standing on the Exchange (e.g., compliance with the equity and options rules of the Exchange, OCC, and FRB).

As discussed, options trading on the Exchange has developed into a robust hybrid system that is currently largely electronic and off-floor. The Exchange continues to have an open outcry trading floor, however, rather than a proliferation of competitive specialists on the options floor as was the case when Rule 511 was instituted: there is currently one specialist unit on the options floor and therefore Rule 511 is not needed. In the past, when so many specialists conducted business on the options floor, Rule 511 served a purpose. Today, Rule 511, with its specialist evaluation process and allocation process constructed for multiple competitive specialists on the floor, is no longer needed

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<sup>37</sup> See, e.g., Rule 501 (Specialist Appointment); Rule 506 (Allocation Application, Allocation, Reallocation, and Transfer); Rule 508 (Transfer Application); and Rule 513 (Voluntary Resignation of Options Privileges). See also, e.g., Rule 1022 (Securities Accounts and Orders of Specialists and Registered Options Traders; and Rule 1020 (Registration and Functions of Options Specialists), which discusses on-floor options specialists and electronic Remote Specialists.

with one specialist unit on the floor.<sup>38</sup> As such, in light of the current realities of the options floor Rule 511 is obsolete, particularly in light of numerous rules in the Phlx rulebook that apply to specialists.

The many rules that continue to apply to specialists discuss topics such as application, approval, allocation, re-allocation, market making, and obligations of specialists. For example, Rule 501 as proposed discusses the specialist allocation process and specialist approval process. To be an approved specialist unit and retain the privilege of such status, for example, a specialist unit must maintain the approved clearing arrangements and capital structure stated on their application and changes regarding certain requirements must be submitted and approved by the Exchange. In addition, each unit must consist of at least one head specialist and one assistant specialist that must be associated with the specialist unit; the Exchange, in its discretion, may require a unit to obtain additional staff depending upon the number of assigned options classes and associated order flow. Rule 506 discusses allocation application, reallocation of a previously allocated options, and transfer of allocated options.<sup>39</sup> Rule 506 also discusses that, in addition to a minimum allocation period of one year, the Exchange may establish an “alternate specialist period” period of less than one year to act as a specialist in an options class. Rule 508 as proposed discusses the Exchange approval process if there is agreement between or among specialist units to transfer one or more options classes

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<sup>38</sup> The Exchange believes that even if additional floor specialists begin to conduct business on the options floor, Rule 511 was designed for a very different competitive floor environment and is not needed, particularly in light of proposed Rule 510 and the numerous other Exchange rules applicable to options specialists.

<sup>39</sup> See Securities Exchange Act Release No. 77121 (February 11, 2016), 81 FR 8308 (February 18, 2016) (SR-Phlx-2016-22) (notice of filing and immediate effectiveness to delete Rule 505 and update Rule 506).

already allocated to a specified specialist unit. Rule 513, which is not proposed to be amended with this filing, discusses the process if an option specialist unit voluntarily resigns from allocation in a particular option and there is a future allocation regarding such option.<sup>40</sup> In addition, Rule 1014 discusses the obligations and restrictions applicable to specialists and registered options traders during each trading day; these obligations and restrictions include, as discussed above, very specific market making requirements. Finally, Rule 1022 discusses securities accounts and orders of specialists and registered options traders and proper identification of accounts, reporting of options, and orders of underlyings.<sup>41</sup>

The Exchange believes that the changes to the noted rules in the Series 500 Rules will make remaining Rules 501, 507, 508, and 510 easier to apply, clearer and better.

b. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>42</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>43</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, in general, to protect investors and the public interest by proposing to make changes to five rules in the

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<sup>40</sup> One rule in the Series 500 Rules does not specifically deal with specialists. This is Rule 507, which was discussed above. This rule deals with the application and approval process for SQTs, RSQTs, or RSQTOs, and the assignment of options.

<sup>41</sup> The Exchange has previously discussed that the allocation and evaluation process in Rule 511 proposed to be deleted made sense when the rule was established with multiple competitive specialists on the floor, but is no longer needed in light of the current composition of the floor.

<sup>42</sup> 15 U.S.C. 78f(b).

<sup>43</sup> 15 U.S.C. 78f(b)(5).

Series 500 Rules as discussed. The proposed rule change is designed to promote just and equitable principles of trade by updating and modernizing the Series 500 Rules and making them clearer and easier to use while continuing to protect investors and the public interest.

In particular, the Exchange is proposing to change Rule 501 to delete reference to a back-up specialist. With the development of liquidity-enhancing electronic market makers on the Exchange such as RSQTs, which make markets in the same options issues as specialists, and the diminution of the role that the specialist plays in managing the order book on the Exchange, both a back-up specialist and substitute specialist are no longer needed. The Exchange believes that this proposal amendment is consistent with the Act because the advent of streaming quote traders on the Exchange served to perfect the mechanism of a free and open market because of the liquidity that such participants brought to Phlx. These participants are obligated to continuously quote in the market and have filled a role which was previously reliant on a back-up specialist and a substitute specialist.

Obsolete language in Rule 501 in respect of back-up specialists, which includes Commentary .01 to Rule 501, is proposed to be deleted from Rule 501. Similarly, the Exchange is proposing to change Rule 508 to delete the cross reference to Rule 511 and references to “lease.” As discussed, with the change in Rule 510 to the good standing standard that applies to specialists as well as SQTs and RSQTs, Rule 511 is proposed to be deleted and therefore the reference is no longer needed. Moreover, leasing is no longer permitted on the Exchange, and for this reason the Exchange is proposing to delete



this obsolete term from Rule 508. The Exchange believes it is consistent with the Act to delete obsolete references which serve to confuse members within the Rulebook.

The Exchange is proposing to amend Rule 507(a) to permit the Exchange, instead of the Board to defer approval of qualifying applications for SQT or RSQT status pending any action required to address the issue of concern to the Exchange. The applicant would have a right of appeal to the Board or a Board Panel of any action of Exchange staff pursuant to Rule 507(e). The Exchange believes that the application process should be handled by staff initially with appellate rights to the Board or a Board Panel. Currently Rule 507 states that the Board has the ability to perform functions such as deferring or limiting approval of SQTs or RSQTs. The Exchange believes that this amendment is consistent with the Act because it will change will promote just and equitable principles of trade by serving the administration and application of Rule 507 and permitting a right of appeal as provided in Rule 507(e).

With respect to Rule 507(e), the Exchange proposes to expand the appeal to either the Board or a Board Panel. Currently, Rule 507(e) states that an appeal shall be heard by a special committee of the Directors composed of three Directors, of whom at least one (1) shall be an Independent. The Exchange proposes to state that the appeal may be heard by a panel appointed by the Board composed of three (3) members not involved in the Exchange decision appealed from and who otherwise have no conflict of interest. If a panel is appointed by the Board, three persons shall be selected to serve on the panel and in making such selections the Board shall choose individuals whose background, experience and training qualify them to consider and make determinations regarding the subject matter to be presented to the panel. The panel shall consist of two members of

the Exchange, or general partners or officers of member organizations and one other person who would qualify as a public member as defined in Article I of the By-Laws, whom the Board considers to be qualified. The Exchange believes that this amendment is consistent with the Act because the Board or a Board Panel would allow a path of impartial appeal for the applicant.

Also, currently Rule 507(b) states that when making a decision concerning an application for assignment in an option the Exchange shall consider the applicant's prior performance as a specialist, SQT or RSQT based on evaluations conducted pursuant to Exchange Rule 510. The Exchange proposes to update Rule 510 so that in lieu of the current formulaic language in the rule, there is new language that accentuates the good standing of members. In light of this, the Exchange proposes to update the 507(b) reference to state that the Exchange can consider the applicant's prior performance as a specialist, SQT or RSQT based on "good standing pursuant to Rule 510." The Exchange believes that this amendment is consistent with the Act because it will consider a more holistic approach in evaluating members that engage in market making activities. The Exchange believes that this approach is broader and will take new factors into account which would serve to promote just and equitable principles of trade in evaluating market participants that engage in market making activities by considering their obligations and past performance.

The Exchange is proposing to update Rule 510 to give it a new title, "Good Standing for Specialist, SQT, and RSQT," to add relevant good standing language, and appeal rights. The Exchange proposes to amend the language of Rule 510 to indicate that, with the deletion of Rule 511, Rule 510 will also be applicable to specialists. The

Exchange proposes to change the language of Rule 510 to more closely align the Exchange with BX Options by adopting language from the BX Options rule at Chapter VII, Section 4. BX Options Market Makers are held to good standing standards per the BX Options rule. Specialists on Phlx are another type of market maker. The Exchange believes that these amendments are consistent with the Act because these changes serve to add clarity and transparency to the rule text.

The Exchange is adopting language from BX Options at Chapter VII, Section 4. Specifically, the Exchange proposes new language in Rule 510(a) to state that to remain in good standing on the Exchange as a specialist (including Remote Specialist), SQT, or RSQT, the specialist, SQT, or RSQT must meet specific requirements set forth in the rule.<sup>44</sup> As discussed, the proposed new good standing language in Rule 510 will be, in all material respects, similar to BX Options rules at Chapter VII, Section 4. This makes particular sense because all BX Options Market Makers are designated as specialists on BX for all purposes under the Act or rules thereunder and, like Phlx specialists, have market making obligations.<sup>45</sup> The Exchange believes that the good standing rule text is consistent with the Act because as described above the Exchange believes that this approach is broader and will take new factors into account which would serve to promote

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<sup>44</sup> The specific good standing requirements are: i) continue to meet the requirements established in SEC Rule 15c3-1(a)(6)(i), and the requirements set forth in the Series 500 Rules in the Rules of the Exchange; ii) continue to satisfy the specialist, SQT or RSQT qualification requirements specified by the Exchange, as amended from time to time; iii) comply with the Rules of the Exchange and the Options Rules as well as the rules of the Options Clearing Corporation and the rules of the Federal Reserve Board; and iv) pay on a timely basis such member, transaction and other fees as the Exchange shall prescribe. Proposed Rule 510(a).

<sup>45</sup> See, e.g., supra note 24 and accompanying discussion.

just and equitable principles of trade in evaluating market participants that engage in market making activities by considering their obligations and past performance.

The Exchange is proposing to add an Informal Meeting process and appeal rights, which do not exist in Rule 510 for specialists; as discussed, the appeal rights now in Rule 510 are regarding SQTs and RSQTs only in respect of performance evaluations. These proposed appeal rights for a specialist (including Remote Specialist), SQT, or RSQT, which are set forth in Rule 510(c) for, are adopted from Rule 511. The memorialization in Rule 510 of Informal Meeting process and appeal rights is done to affirm that if the good standing of a specialist, SQT, or RSQT is suspended, terminated or otherwise withdrawn then they have a clear way to meet with the Exchange to discuss the issue and initiate and prosecute an appeal regarding such decision. The Exchange's proposal to expand the role of the Board to permit an appeal to be heard by a Board Panel appointed by the Board composed of three (3) members not involved in the Exchange decision appealed from and who otherwise have no conflict of interest is consistent with the Act because the Board or a Board Panel would allow a path of impartial appeal for the applicant.<sup>46</sup>

The Exchange has concluded that, with the placement of the good standing concepts into proposed Rule 510 in such a way that they include a specialist (and Remote

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<sup>46</sup> If a Board Panel is appointed by the Board, three persons shall be selected to serve on the Board Panel and in making such selections the Board shall choose individuals whose background, experience and training qualify them to consider and make determinations regarding the subject matter to be presented to the Board Panel. The Board panel shall consist of two members of the Exchange, or general partners or officers of member organizations and one other person that would qualify as a public member as defined in Article I of the By-Laws, whom the Board considers to be qualified.

Specialist), Rule 511 is no longer needed and is therefore proposed to be deleted in its entirety (with transfer of specialist appeal rights from Rule 511 to Rule 510).

The Exchange is proposing to delete Rule 511. This rule was established decades ago for the purpose of dealing with the extensive on-floor open outcry specialist system, with multiple competing specialist units. Since the implementation of Rule 511, the open outcry options floor has evolved into a robust and competitive system that is principally electronic, and the remaining hybrid options floor does not have numerous competing specialists as was the case when Rule 511 was instituted. The Exchange believes that because of the extensive changes on the option floor (from having numerous competitive specialist units on the old options floor to having a specialist unit on the current options floor), and because specialists are proposed to be covered in Rule 510 in terms of good standing and continue to be covered in the Series 500 Rules and other rules of the Exchange, it is consistent with the Act and promotes just and equitable principles of trade to delete Rule 511.

Furthermore, numerous rules in the Phlx Rulebook continue to apply to specialists (as well as to other registered options traders). For example, Rule 501 as proposed discusses the specialist allocation process and specialist approval process. Rule 506 discusses allocation application, reallocation of previously allocated options, and transfer of allocated options. Rule 508 as proposed discusses the Exchange approval process if there is agreement between or among specialist units to transfer one or more options classes already allocated to a specified specialist unit. Rule 513, which is not proposed to be amended with this filing, discusses the process if an option specialist unit voluntarily resigns from allocation in a particular option and there is a future allocation regarding

that option. Rule 1014 discusses the obligations and restrictions, including specific market making requirements, that are applicable to specialists each trading day. Finally, Rule 1022 discusses proper identification of accounts, reporting of options, and orders of underlyings in respect of securities accounts and orders of specialists and ROTs.

The Exchange believes that the changes to the noted rules in the Series 500 Rules will make remaining Rules 501, 507, 508, and 510 easier to apply, clearer and more transparent. Such proposed changes are in consistent with the Act, the public interest, and continue to serve to protect investors.

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

The Exchange 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. While the Exchange does not believe that the proposed change is a burden on competition, or is competitive in nature, the Exchange believes that clearer, updated, modernized, and better-conforming rules that do not refer to obsolete concepts are always beneficial to market participants, are in the public interest, and serve to protect investors.

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

Not applicable.

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

The Exchange requests the Commission to grant accelerated approval so that the Series 500 Rules can, as soon as possible, be modernized and updated. The Exchange

believes that these proposals will improve the functioning and consistency of the Series 500 Rules in light of the development of the options floor since the Series 500 Rules came into existence. The Exchange believes that good reason exists for accelerated approval, and that such waiver would be consistent with the protection of investors and in the public interest.

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 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-2016-105)

February \_\_, 2016

Self-Regulatory Organizations; NASDAQ PHLX LLC; Notice of Filing of Proposed Rule Change to Amend Rules 501, 507, 508, 510, and 511

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 February 15, 2016, NASDAQ PHLX LLC (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend Rule 501 (Specialist Appointment), Rule 507 (Application for Approval as an SQT, RSQT, or RSQTO and Assignment in Options), Rule 508 (Transfer Application), Rule 510 (SQT and RSQT Performance Evaluation), and Rule 511 (Specialist Allocation and Performance Evaluation).<sup>3</sup> The proposed amendments are described further below. This Amendment No. 1 supersedes the original filing in its entirety.

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

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

<sup>3</sup> References to rules are to Phlx rules unless otherwise noted. The terms SQT, RSQT, RSQTO, and Specialist are discussed below.



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

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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The Exchange proposes to amend: (1) Rule 501 to delete a reference to a back-up specialist; (2) Rule 507 to: update the reference to "Board" to permit the Board to appoint a panel; update the composition of the review committee; and update the reference to Rule 510; (3) Rule 508 to delete the reference to "lease" and the cross-reference to Rule 511; (4) Rule 510 to re-entitle the rule "Good Standing for Specialist, SQT, and RSQT,"<sup>4</sup> and add relevant good standing language, and appeal rights; and (5) Rule 511 to delete the rule.

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<sup>4</sup> "Specialist" is an Exchange member who is registered as an options specialist pursuant to Rule 1020(a). "Remote Specialist" is a specialist that does not have a physical presence on the floor of the Exchange. Streaming quote trader ("SQT") and remote streaming quote trader ("RSQT") are electronic traders on the Exchange pursuant to Rule 1014(b)(ii)(A) and Rule 1014(b)(ii)(B), respectively.

Rules 501, 507, 508, 510, and 511 are part of the 500 series of rules in the Rules of the Exchange (the “Series 500 Rules”), which are entitled “Allocation, SQT, RSQT, and Evaluation Rules (Rule 500 - 599).”<sup>5</sup> Many Series 500 Rules were established more than three decades ago with the advent of options trading on the Exchange,<sup>6</sup> at which time Exchange options trading was strictly on-floor open outcry through specialists. Exchange options trading has, since that time, developed into a robust hybrid system that is currently largely electronic and off-floor<sup>7</sup> but continues to have an on-floor specialist<sup>8</sup>

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<sup>5</sup> These Series 500 Rules apply to Exchange members that trade options. The Exchange continues to have a hybrid options floor, but no longer has an equities floor or a commodities floor.

<sup>6</sup> For example, Rules 501, 505, and 506, were adopted on a pilot basis in 1982. See Securities Exchange Act Release No. 18975 (August 17, 1982), 47 FR 37019 (August 24, 1982) (approval order regarding pilot in respect of Rules 501-506 and authorizing the Phlx Allocation, Evaluation and Securities Committee, which no longer exists). See also Securities Exchange Act Release No. 18975 (August 17, 1982), 47 FR 37019 (August 24, 1982) (SR-Phlx-81-1) (approval order regarding Rules 100, 201, 203 and 214 in combination with Rules 500 through 505). Rules 500, 501, 505, 506, 508, 511, 515, 520, 522, 523, 525, and 526 (of which Rules 500, 515, 516, 520, 522, 523, 525, and 526 no longer exist) were permanently approved in 1991. See Securities Exchange Act Release No. 29369 (June 26, 1991), 56 FR 30604 (July 3, 1991) (SR-Phlx-87-42) (order granting permanent approval). Rule 507 was adopted in 2004. See Securities Exchange Act Release No. 50100 (July 27, 2004), 69 FR 46612 (August 3, 2004) (SR-Phlx-2003-59) (order granting approval). Rule 510 was adopted in 2007. See Securities Exchange Act Release No. 55080 (January 10, 2007), 72 FR 2324 (January 18, 2007) (SR-Phlx-2006-51) (order granting approval). The Exchange has filed a separate proposal regarding two of the rules in the Series 500 Rules, namely Rules 505 and 506. See Securities Exchange Act Release No. 77121 (February 11, 2016), 81 FR 8308 (February 18, 2016) (SR-Phlx-2016-22) (notice of filing and immediate effectiveness to delete Rule 505 and update Rule 506).

<sup>7</sup> Electronic traders include Registered Options Traders or “ROTs,” that are Streaming Quote Traders or “SQTs”, Remote Streaming Quote Traders or “RSQTs,” as well as off-floor specialists (Remote Specialists) (collectively “market makers”). See Rules 1014(b)(ii)(A), 1014(b)(ii)(B), and 1020.

<sup>8</sup> Unlike specialists, Remote Specialists do not have a physical presence on the floor of the Exchange. Rule 1020.

and an open outcry trading floor. The Exchange is now updating and modernizing the Series 500 Rules as discussed below.<sup>9</sup>

#### Updating Rule 501

The Exchange proposes in Rule 501 to delete the reference to a back-up specialist.

Currently, Rule 501 states that initial application(s) to become a specialist unit shall include information regarding the specialist, back-up specialist unit and a substitute specialist unit. With the development of liquidity-enhancing electronic market makers on the Exchange such as RSQTs, which make markets in the same options issues as specialists, and the diminution of the role that the specialist plays in managing the order book on the Exchange, both a back-up specialist and substitute specialist are no longer needed.<sup>10</sup> Therefore, obsolete language in Rule 501 in respect of back-up specialists, which includes Commentary .01 to Rule 501, is proposed to be deleted from Rule 501. All of the other initial application requirements of Rule 501, which include the following information, remain unchanged: the identity of the individual who will act as head specialist and as assistant specialist(s) in the unit; the identity of the unit's staff positions and who will occupy those positions; the identity of a substitute specialist unit not associated with the specialist unit, which shall serve as a substitute specialist unit in the

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<sup>9</sup> While the vast majority of options-related rules are found in Rule 1000 and higher (with option index rules found in Rule 1000A and higher), some of the older options-related rules are, as discussed, in the Series 500 Rules.

<sup>10</sup> The function of a back-up specialist unit not associated with the specialist unit, as in current Rule 501(b), is for one specialist unit on the floor to provide staffing when needed to another specialist unit on the floor. Because multiple specialist units are no longer present on the floor, the back-up function is no longer feasible. Moreover, as discussed below, the specialist unit must clearly indicate its staffing to the Exchange, and the substitute specialist requirement continues unchanged.

event that the specialist unit is unable to perform the duties of a specialist; the unit's clearing arrangements; and the unit's capital structure, including any lines of credit.<sup>11</sup>

#### Updating Rule 507

The Exchange proposes in Rule 507 to update the reference to "Board," update the composition of the review committee, and update the reference to Rule 510.

First, Rule 507(a) currently states that the Board has the ability to perform functions such as deferring or limiting approval of SQTs or RSQTs. The Exchange proposes to replace the role of the Board with Exchange staff. The Exchange may therefore defer, for a period to be determined in the Exchange's discretion, approval of qualifying applications for SQT or RSQT status pending any action required to address the issue of concern to the Exchange. The Exchange's Membership department<sup>12</sup> may not defer a determination of the approval of the application of any SQT or RSQT applicant or place any limitation(s) on access to the Exchange's electronic quoting and trading system on any SQT or RSQT applicant unless the basis for such limitation(s) or deferral have been objectively determined by the Exchange, subject to Securities and Exchange Commission approval or effectiveness pursuant to a rule change filing under Section 19(b) of the Securities Exchange Act of 1934, as amended. The Exchange shall provide written notification to any SQT or RSQT applicant whose application is the subject of such limitation(s) or deferral, describing the objective basis for such limitation(s) or deferral. The Exchange believes that this change will help with the

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<sup>11</sup> Rule 501(a) and (b).

<sup>12</sup> Applications for SQTs and RSQTs would be reviewed by the Membership department. Today, the Exchange's Membership Department review applications for membership to Phlx for both equities and options members.

administration and application of Rule 507. Also, there is an appeal to the Board from any action of Exchange staff within Rule 507(e).

Second, Rule 507(e) currently states that an appeal to the Board from a decision of the Exchange regarding an SQT, RSQT, or RSQTO<sup>13</sup> application may be requested by a member or member organization; and that such appeal shall be heard by a special committee of the Board composed of three (3) Directors, at least one of whom will be Independent. In light of and commensurate with the first proposed Rule 507 change regarding the Board, the Exchange proposes to state that any appeal from a decision pursuant to Rule 507 may be heard by the Board or a panel appointed by the Board (“Board Panel”) composed of three (3) members not involved in the Exchange decision appealed from and who otherwise have no conflict of interest;<sup>14</sup> and that, as now, there

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<sup>13</sup> “RSQTO” is a Remote Streaming Quote Trader Organization with up to five affiliated RSQTs. Rule 507(a).

<sup>14</sup> The language stating that one of the Board members shall be an Independent is proposed to be deleted. The Exchange believes that this is proper as the “Independent” label is now a distinction with little, if any, effect. Whereas the vast majority of Phlx Board members were not Independent when Rule 507 was put into place and the Exchange was a membership corporation, and application of the Independent label may have made sense under those circumstances, the composition of the Phlx Board has radically changed since Phlx became a subsidiary of a public company, Nasdaq, Inc., in 2008. The By-Laws of the Exchange now provide that the Exchange may have Public Directors, Non-Industry Directors, and Industry Directors; and that Industry Directors may include no more than two officers of the Exchange, selected at the sole discretion of the Board, which may serve in the role of Staff Director (not Independent). Phlx By-Laws Article I. See also Securities Exchange Act Release No. 77165 (February 17, 2016), 81 FR 9041 (February 23, 2016) (SR-BSECC-2015-002; SR-SCCP-2015-02; SR-BX-2015-085; SR-NASDAQ-2015-160; SR-Phlx-2015-113) (order granting approval). Now, all but one of the twelve members on the Phlx Board are Independent (the only exception being one Staff Board member who is an officer of the Exchange). Thus, in light of the composition of the Phlx Board, which has one Staff Board member, only one of the three Directors on the special committee discussed in current Rule 507 could even possibly be not Independent; and, by Phlx By-Laws no more than two Directors could ever be not

shall be no appeal to the Board from a decision of the Board Panel. If a Board Panel is appointed by the Board, three persons shall be selected to serve on the Board Panel and in making such selections the Board shall choose individuals whose background, experience and training qualify them to consider and make determinations regarding the subject matter to be presented to the Board Panel. The Exchange notes that references to “special committee” will now refer to “Board” or “Board Panel” with this proposal. The Board Panel shall consist of two members of the Exchange, or general partners or officers of member organizations and one other person that would qualify as a public member as defined in Article I of the By-Laws, whom the Board considers to be qualified.

Third, Rule 507(b) currently states that, when making a decision concerning an application for assignment in an option, the Exchange shall consider the applicant’s prior performance as a specialist, SQT, or RSQT based on evaluations conducted pursuant to Exchange Rule 510.<sup>15</sup> The Exchange is, as discussed below, proposing to update Rule 510 so that in lieu of the current formulaic language in the rule, there is new language

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Independent. The Exchange believes that, distinct from the Independent criteria, the ability of the Board to appoint a panel as proposed will serve to enhance the ability to quickly assemble a panel in case of potential appeal, if one occurs. The Exchange notes that a special committee per Rule 507 has not been instituted since, let alone before, Phlx became a subsidiary of Nasdaq, Inc. The Exchange also notes that the compositional requirements for the Boards that oversee the three options markets under the umbrella of Nasdaq, Inc. (Phlx, The NASDAQ Options Market LLC (“NOM”), and NASDAQ BX, Inc. (“BX Options”)) are similar. While there is no requirement in this proposal for an Independent panel member to be appointed to the Board Panel, the Exchange notes that the public member has some independent aspect. See Phlx By-Laws at Article I (hh), “The term ‘public member’ means a member of any committee appointed by the Board of Directors who has no material business relationship with a broker or dealer, the Exchange, or its affiliates.”

<sup>15</sup> Other factors for consideration include: (A) the financial and technical resources available to the applicant; and (B) the applicant’s experience and expertise in market making or options trading. Rule 507(b).

that accentuates the good standing of members. In light of this, the Exchange proposes to update the 507(b) reference to state that the Exchange can consider the applicant's prior performance as a specialist, SQT or RSQT based on "good standing pursuant to Rule 510." The Exchange is not proposing any other change to Rule 507. The Exchange notes that the other aspects of Rule 507, such as, for example, RSQTO eligibility criteria,<sup>16</sup> SQT and RSQT eligibility criteria,<sup>17</sup> and technological ability for RSQTOs, SQTs, or RSQTs,<sup>18</sup> remain in place.<sup>19</sup>

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<sup>16</sup> These RSQTO criteria include: (A) Significant market-making and/or specialist experience in a broad array of securities; (B) Superior resources, including capital, technology and personnel; (C) Demonstrated history of stability, superior electronic capacity, and superior operational capacity; (D) Proven ability to interact with order flow in all types of markets; (E) Existence of order flow commitments; (F) Willingness to accept allocations as an RSQT in options overlying 400 or more securities; and (G) Willingness and ability to make competitive markets on the Exchange and otherwise to promote the Exchange in a manner that is likely to enhance the ability of the Exchange to compete successfully for order flow in the options it trades. Rule 507(a)(i).

<sup>17</sup> These SQT and RSQT criteria include: (A) Significant market-making and/or specialist experience in a broad array of securities; (B) Superior resources, including capital, technology and personnel; (C) Demonstrated history of stability, superior electronic capacity, and superior operational capacity; (D) Proven ability to interact with order flow in all types of markets; (E) Willingness and ability to make competitive markets on the Exchange and otherwise to promote the Exchange in a manner that is likely to enhance the ability of the Exchange to compete successfully for order flow in the options it trades; (F) A current affiliation with an Exchange-approved RSQTO (RSQT applicants only). Rule 507(a)(ii).

<sup>18</sup> No application for initial assignment in an option shall be approved without verification that (A) the RSQTO, SQT or RSQT applicant has sufficient technological ability to support his/her continuous quoting requirements as set forth in Rule 1014(b)(ii), and (B) the RSQTO, SQT or RSQT applicant has successfully completed, or is scheduled to complete, testing of its quoting system with the Exchange. Rule 507(b)(ii).

<sup>19</sup> Specialist (and Remote Specialist) eligibility and qualification requirements are discussed in Rules 501, 506, 1014, and 1020.

### Updating Rule 508

The Exchange proposes in Rule 508 to delete the reference to “lease” and to Rule 511.

First, Rule 508 currently refers to “lease.” Leasing is no longer practiced on the Exchange, and for this reason the Exchange is proposing to delete this obsolete term from Rule 508. This is similar to a recent proposal wherein the Exchange noted that leasing is an obsolete term that should be deleted.<sup>20</sup>

Second, Rule 508 currently refers to Rule 511, regarding specialists. The Exchange proposes to delete the Rule 508 reference to Rule 511. This is because, as discussed below, Rule 511 is proposed to be deleted as the language of Rule 510 is proposed to be modified to include specialists.<sup>21</sup>

### Updating Rule 510

The Exchange proposes to entitle Rule 510 “Good Standing for Specialist, SQT, and RSQT” and to add relevant good standing language.

First, Rule 510 currently applies only to SQTs and RSQTs. The Exchange proposes to change the language of Rule 510 to indicate that this rule will also be applicable to specialists. Thus, the Exchange proposes to entitle Rule 510 as “Good Standing for Specialist, SQT, and RSQT.” The good standing requirement, which is discussed below, is a continuous requirement rather than a periodic evaluation

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<sup>20</sup> See Securities Exchange Act Release No. 77121 (February 11, 2016), 81 FR 8308 (February 18, 2016) (SR-Phlx-2016-22) (notice of filing and immediate effectiveness to delete Rule 505 and update Rule 506).

<sup>21</sup> Rule 508 will continue to indicate, without reference to Rule 511, that failure to provide the Exchange prior notice of a transfer in accordance with Rule 508, or failure to obtain Exchange approval of a transfer, permits the Exchange to recover the allocated securities and reallocate them pursuant to Rule 506.



requirement as in current Rules 510 and 511.<sup>22</sup> The requirements to remain in good standing are discussed in the new language in Rule 510(a). These obligations will be continuous and not periodic. The Exchange will provide written notice to a specialist (including Remote Specialist), SQT, or RSQT of a contemplated action regarding good standing pursuant to Rule 510, as noted below. A specialist (including Remote Specialist), SQT, or RSQT may request and the Exchange may hold an informal meeting to discuss the alleged failure to remain in good standing and to explore possible appropriate remedies. Written notice of the date and time of the meeting will be given to the specialist (including Remote Specialist), SQT, or RSQT and no verbatim record will be kept. If the Exchange believes there are no mitigating circumstances that would demonstrate substantial improvement of or reasonable justification for the failure to meet the good standing requirements of this Rule 510, the Exchange may take appropriate action pursuant to subsection (b) of this Rule 510. This process is described in further detail below. Exchange staff will evaluate good standing which entails continuous compliance with, among other things, Exchange options rules and procedures as well as market making requirements (market making requirements are found in Rule 1014).

Second, Rule 510 currently is written in terms of doing performance evaluations for SQTs and RSQTs. Currently, Rule 507 has a very detailed process for applying for and approving SQTs and RSQTs, and for assigning options to SQTs and RSQTs. In

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<sup>22</sup> Proposed Rule 510, which applies to specialists (including Remote Specialists), SQTs, and RSQTs, discusses that good standing on the Exchange means continuous compliance with, among other things, Exchange options rules and procedures as well as market making requirements (market making requirements are found in Rule 1014). In light of the proposed continuous and extensive good standing requirements per Rule 510 as well as other rule requirements, the old evaluations applicable to SQTs, RSQTs, and specialists are not needed.

addition, today Rule 501 defines the application and approval process for specialists.<sup>23</sup>

To more closely align the Exchange with another options exchange, namely BX Options, the Exchange is adopting language similar to BX Options Rule at Chapter VII, Section 4 (the “BX Options rule”).<sup>24</sup> Similar to Phlx, BX Options has market makers (“BX Options Market Makers”, which are also known as lead market makers (“LMMs”). All BX Options Market Makers are designated as specialists on BX for all purposes under the Act or rules thereunder.<sup>25</sup> The Exchange is adopting the BX Options rule and proposing, in lieu of the current formulaic language in Rule 510, to insert new language indicating how a member of the Exchange can remain in good standing on the Exchange. The

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<sup>23</sup> Rules 506, 508, and 513 discuss other aspects of the process.

<sup>24</sup> See Securities Exchange Act Release No. 67256 (June 26, 2012), 77 FR 39277 (July 2, 2012) (order approving establishment of BX Options and marketplace rules) (SR-BX-2012-030).

<sup>25</sup> See BX Options Chapter VII, Section 2.

For obligations of BX Options Market Makers, see BX Options Chapter VII, Section 5, entitled “Obligations of Market Makers.” This section indicates that BX Options Markets Maker obligations include, but are not limited to: maintain a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market in transactions where acting in a market making capacity; not make bids or offers or enter into transactions that are inconsistent with such course of dealings; maintain a two-sided market, during trading hours, in those options in which the Market Maker is registered to trade, in a manner that enhances the depth, liquidity and competitiveness of the market; compete with other Market Makers in all options in which the Market Maker is registered to trade; update quotations in response to changed market conditions in all options in which the Market Maker is registered to trade; and maintain active markets in all options in which the Market Maker is registered.

The BX Options Market Maker obligations are similar in nature to those of Phlx specialists, which can be found in Phlx Rule 1014, entitled “Obligations and Restrictions Applicable to Specialists and Registered Options Traders,” and include: maintain a fair and orderly market; not enter into transactions or make bids or offers that are inconsistent with such a course of dealings; quote a two-sided market; and maintain a two-sided market.

Exchange believes that this new proposal will obligate market participants that conduct market making activities with continuous requirements to remain in good standing as compared to periodic requirements. The continuous requirements will serve to accentuate the good standing of members who have remained in compliance. The Exchange believes that it is important for market structure for these participants to have continuous requirements to remain in good standing rather than only periodic evaluations.

The proposed new language is similar, in all material respects,<sup>26</sup> to BX Options rule at Chapter VII, Section 4. Specifically, the Exchange proposes to adopt new language in Rule 510(a) to state that to remain in good standing as a specialist (including Remote Specialist), SQT, or RSQT, the specialist, SQT, or RSQT must:

- (i) continue to meet the requirements established in SEC Rule 15c3-1(a)(6)(i),<sup>27</sup> and the requirements set forth in the Series 500 Rules in the Rules of the Exchange;
- (ii) continue to satisfy the specialist, SQT or RSQT qualification and market making requirements specified by the Exchange, as amended from time to time;
- (iii) comply with the Rules of the Exchange and the Options Rules<sup>28</sup> as well as the rules of The Options Clearing Corporation (“OCC”) and the rules of the Federal Reserve Board “FRB”); and

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<sup>26</sup> As with virtually all rules text copied from another exchange, changes are made to the proposed rule text to better fit the structure of the existing rules of the Exchange.

<sup>27</sup> SEC Rule 15c-3, 240 CFR 15c3-1, is the net capital requirement for brokers or dealers.

- (iv) pay on a timely basis such member, transaction and other fees as the Exchange shall prescribe.<sup>29</sup>

These proposed requirements to remain in good standing on the Exchange are not periodic, as are the evaluation and performance concepts in current Rules 510 and 511, but rather are continuous in nature.

Third, the Exchange notes that with the proposed new good standing requirements, specialist and other market maker (e.g., RSQT) obligations, such as market making, will continue to apply.<sup>30</sup> For specialists (and RSQTs functioning as Remote Specialists) the Rule 1014 market making obligations are applicable throughout the trading day. Thus, a specialist (or Remote Specialist) shall continue to be responsible to quote two-sided markets in the lesser of 99% of the series or 100% of the series minus one call-put pair in each option in which such specialist is assigned. To satisfy this requirement with respect to quoting a series, the specialist must quote such series 90% of the trading day (as a percentage of the total number of minutes in such trading day) or such higher percentage as the Exchange may announce in advance. These obligations will apply collectively to all appointed issues of the specialist, rather than on an issue-by-issue basis. Compliance with this obligation will be determined on a monthly basis.

However, determining compliance with the continuous quoting requirement on a monthly

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<sup>28</sup> As discussed, while the vast majority of options-related rules are found in Rule 1000 and higher (with option index rules in Rule 1000A and higher), some of the older options-related rules are found in rules below 1000, such as, for example, the Series 500 Rules.

<sup>29</sup> Member assessments are generally reflected in the Phlx Pricing Schedule.

<sup>30</sup> Other obligations include, for example: order exposure, order handling, and best execution.

basis does not relieve the specialist (including the Remote Specialist) of the obligation to provide continuous two-sided quotes on a daily basis, nor will it prohibit the Exchange from taking disciplinary action against the specialist (including the Remote Specialist) for failing to meet the continuous quoting obligation each trading day.<sup>31</sup>

Fourth, the proposed new language in Rule 510(b) states that the good standing of a specialist (including Remote Specialist), SQT, or RSQT may be suspended, terminated or otherwise withdrawn, as provided in the Exchange's rules, if any of these conditions for approval cease to be maintained or the specialist, SQT, or RSQT violates any of its agreements with the Exchange or any of the provisions of the Rules of the Exchange or of the Options Rules. The Exchange is proposing to add an Informal Meeting process and appeal rights, which do not exist in Rule 510 for specialists at this time.

The Informal Meeting process proposed in Rule 510 is based on the Informal Meeting process in current Rules 510 (for SQTs and RSQTs) and 511 (for specialists), which is in respect of performance evaluations. The Informal Meeting process proposed in Rule 510 is, however, in respect of good standing. Specifically, the Exchange proposes to amend Rule 510 to adopt the following language in Rule 510(b)(i): The Exchange will provide written notice to a specialist (including Remote Specialist), SQT,

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<sup>31</sup> See Rule 1014(b)(ii)(D)(2).

For the market making obligations of SQTs and RSQTs (including Directed SQT or DRSQTs, and Directed RSQTs or DRSQTs), which remain unchanged, see Rule 1014(b)(ii)(D)(1). This rule states that, like for specialists, compliance for SQTs and RSQTs will be determined on a monthly basis. However, determining compliance with the continuous quoting requirement on a monthly basis does not relieve an SQT, RSQT, DSQT, or DRSQT of the obligation to provide continuous two-sided quotes on a daily basis, nor will it prohibit the Exchange from taking disciplinary action against an SQT, RSQT, DSQT, or DRSQT for failing to meet the continuous quoting obligation each trading day. Rule 1014(b)(ii)(D)(1).

or RSQT of a contemplated action regarding good standing pursuant to this Rule 510. A specialist (including Remote Specialist), SQT, or RSQT may request and the Exchange may hold an informal meeting to discuss the alleged failure to remain in good standing and to explore possible appropriate remedies. Written notice of the date and time of the meeting will be given to the specialist (including Remote Specialist), SQT, or RSQT and no verbatim record will be kept. If the Exchange believes there are no mitigating circumstances that would demonstrate substantial improvement of or reasonable justification for the failure to meet the good standing requirements of this Rule 510, the Exchange may take appropriate action pursuant to subsection (b) of this Rule 510. Nothing in this Informal Meeting process limits the Exchange from enforcing the rules of the Exchange, which may include a disciplinary action pursuant to such rules. The Regulatory staff may, for example, initiate a disciplinary action pursuant to Rule 960.3 against a member for failure to meet continuous quoting obligations in Rule 1014.<sup>32</sup> The proposed appeal rights in Rule 510(c) are taken from current Rule 511, but expanded to cover specialists (including Remote Specialists), SQTs, and RSQTs.<sup>33</sup> Specifically, the Exchange proposes to amend Rule 510 to adopt the following language in Rule 510(c):

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<sup>32</sup> Specifically, the Exchange may pursue disciplinary process against a member that commits an egregious market making violation evidenced by a pattern of repeated failure to make a two-sided market in assigned options.

<sup>33</sup> The SQT and RSQT appeal rights to the Board currently in Rule 510 are limited to apply only in respect of performance evaluations. The Exchange believes that the appeal rights afforded SQTs and RSQTs in proposed Rule 510, which will be to the Board or a Board Panel, are appropriate in that they are expanded to cover any decision of the Exchange regarding Rule 510; and, an informal meeting process is also afforded prior to appeal. The Board or a Board Panel would serve as a secondary appeal to a group of individuals that were not involved in the primary decision making. The Exchange is seeking to afford its members due process when seeking an appeal.

An appeal by a specialist (including Remote Specialist), SQT, or RSQT to the Board of Directors from a decision of the Exchange may be requested by a member or member organization interested therein by filing with the Secretary of the Exchange written notice of appeal within ten (10) days after the decision has been rendered. Any appeal from a decision pursuant to Rule 510 may be heard by the Board or a Board Panel composed of three (3) members not involved in the Exchange decision appealed from and who otherwise have no conflict of interest.<sup>34</sup> If a Board Panel is appointed by the Board, three persons shall be selected to serve on the Board Panel and in making such selections the Board shall choose individuals whose background, experience and training qualify them to consider and make determinations regarding the subject matter to be presented to the Board Panel. The Board Panel shall consist of two members of the Exchange, or general partners or officers of member organizations and one other person who would qualify as a public member as defined in Article I of the By-Laws, whom the Board considers to be qualified. The person requesting review shall be permitted to submit a written statement to and/or appear before the Board or Board Panel. The Secretary of the Exchange shall certify the record of the proceeding, if any, and the written decision, and shall submit these documents to the Board or Board Panel. The Board's or Board Panel's review of the action shall be based solely on the record, the written decision and any statement submitted by the person requesting the review. The Board or Board Panel shall prepare

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<sup>34</sup> Rule 511(f) now states, in relevant part, that any appeal from a decision pursuant to Rule 511 regarding evaluation or review shall be heard by a special committee of the Board of Directors composed of three (3) Directors, of whom at least one (1) shall be an Independent. The Exchange believes that, as discussed, the old independence requirement is no longer needed when Rule 510 is restructured. Commensurate with other proposed changes discussed herein, Rule 510 appeals can be heard by the Board or a Board Panel.

and deliver to such person a written decision and reasons therefore. If the Board or Board Panel affirms the action, the action shall become effective ten (10) days from the date of the Board Panel's decision. There shall be no appeal to the Board from any decision of the Board Panel.<sup>35</sup>

The memorialization of appeal rights in proposed Rule 510(c) is done to ensure that if the good standing of a specialist, SQT, or RSQT is suspended, terminated or otherwise withdrawn then they have a clear way to initiate and prosecute an appeal regarding such decision. The proposed due process methodology is similar to other rules of the Exchange. By proposing new language in Rule 510(a) and (b) regarding specialists, SQTs, and RSQTs regarding good standing, which is similar to that of BX Options, the continuous good standing rules of the Exchange and BX Options will be more aligned and easier to apply. Proposed Rule 510 describes an Informal Meeting process and appeal rights applicable to specialists (including Remote Specialists), SQTs, and RSQTs. The Exchange is replacing the current *periodic* evaluation or performance requirements in Rule 510 (e.g., monthly for SQTs and RSQTs), as also in Rule 511 (e.g., annually for specialists) as discussed, with the proposed Rule 510 *continuous* requirements for specialists (including Remote Specialists), SQTs, and RSQTs to meet Exchange, Commission, OCC and FRB rules and requirements to remain in good standing. Compliance with good standing requirements is monitored across the Exchange.<sup>36</sup>

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<sup>35</sup> The appeal process in proposed Rule 507(e) is amended to reflect an appeal to the Board or a Board Panel.

<sup>36</sup> Thus, in Rule 510 the Exchange is proposing an Informal Meeting process and appeal rights applicable to specialists (including Remote Specialists), SQTs, and RSQTs. And, the Exchange is replacing the current *periodic* evaluation or



### Deleting Rule 511

The Exchange has concluded that, with the placement of the good standing concepts into proposed Rule 510 in such a way that they include specialist (and Remote Specialist), Rule 511 is no longer needed. In Rule 510, as discussed, in lieu of the current language, the Exchange is proposing to adopt new language indicating how a member of the Exchange can remain in good standing.

The proposed new language in Rule 510 is, in all material respects, similar to the BX Options rule at Chapter VII, Section 4. Because of this proposed new language in Rule 510, which addresses specialists (as also Remote Specialists, RSQTs, and SQTs), the Exchange proposes to delete Rule 511 in its entirety. The Exchange believes that, within the effort to update and consolidate the Series 500 Rules as discussed, it is reasonable and proper to delete Rule 511. This rule was established decades ago for the purpose of dealing with the extensive on-floor open outcry specialist system, with multiple competing specialist units. Since the implementation of Rule 511, the open outcry options floor has evolved into a robust and competitive principally electronic

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performance requirements in Rule 510 (e.g., monthly for SQTs and RSQTs), as also in Rule 511 (e.g., annually for specialists) as discussed, with the proposed Rule 510 *continuous* requirements for specialists (including Remote Specialists), SQTs, and RSQTs to meet Exchange, Commission, OCC and FRB rules and requirements to remain in good standing. Compliance with good standing requirements is monitored across the Exchange. Thus, for example, units that monitor the application, allocation, and fees requirements and processes include membership, listing, and finance groups. And the surveillance group will continue to use its current processes to monitor compliance with Exchange rules and where appropriate will pursue disciplinary action against members for rule violations(s) (e.g., failure to make two-sided market(s) per Phlx Rule 1014). Moreover, while proposed Rule 510 is being changed the market making and other obligations for specialists, SQTs, and RSQTs continue as discussed.

system, and the remaining hybrid options floor does not have numerous competing specialists as was the case when Rule 511 was instituted.

The Exchange believes that under the circumstances, and because specialists are proposed to be covered in Rule 510 in terms of good standing, and continue to be covered in the Series 500 Rules and other rules of the Exchange,<sup>37</sup> deletion of Rule 511 is proper.

As discussed, the Exchange is deleting the performance evaluation structure of Rule 511 and is proposing to relocate the concept within Rule 510 with the proposed good standing requirement and appeal rights applicable to specialists, SQTs, and RSQTs. The Exchange believes that the proposed good standing approach, which is applicable to specialists, SQTs, and RSQTs, enhances the current rule because unlike the periodic nature of the performance evaluation structure the proposed good standing approach would have continuous requirements that must be maintained in order to remain in good standing on the Exchange (e.g., compliance with the equity and options rules of the Exchange, OCC, and FRB).

As discussed, options trading on the Exchange has developed into a robust hybrid system that is currently largely electronic and off-floor. The Exchange continues to have an open outcry trading floor, however, rather than a proliferation of competitive specialists on the options floor as was the case when Rule 511 was instituted: there is currently one specialist unit on the options floor and therefore Rule 511 is not needed. In the past, when so many specialists conducted business on the options floor, Rule 511

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<sup>37</sup> See, e.g., Rule 501 (Specialist Appointment); Rule 506 (Allocation Application, Allocation, Reallocation, and Transfer); Rule 508 (Transfer Application); and Rule 513 (Voluntary Resignation of Options Privileges). See also, e.g., Rule 1022 (Securities Accounts and Orders of Specialists and Registered Options Traders; and Rule 1020 (Registration and Functions of Options Specialists), which discusses on-floor options specialists and electronic Remote Specialists.

served a purpose. Today, Rule 511, with its specialist evaluation process and allocation process constructed for multiple competitive specialists on the floor, is no longer needed with one specialist unit on the floor.<sup>38</sup> As such, in light of the current realities of the options floor Rule 511 is obsolete, particularly in light of numerous rules in the Phlx rulebook that apply to specialists.

The many rules that continue to apply to specialists discuss topics such as application, approval, allocation, re-allocation, market making, and obligations of specialists. For example, Rule 501 as proposed discusses the specialist allocation process and specialist approval process. To be an approved specialist unit and retain the privilege of such status, for example, a specialist unit must maintain the approved clearing arrangements and capital structure stated on their application and changes regarding certain requirements must be submitted and approved by the Exchange. In addition, each unit must consist of at least one head specialist and one assistant specialist that must be associated with the specialist unit; the Exchange, in its discretion, may require a unit to obtain additional staff depending upon the number of assigned options classes and associated order flow. Rule 506 discusses allocation application, reallocation of a previously allocated options, and transfer of allocated options.<sup>39</sup> Rule 506 also discusses that, in addition to a minimum allocation period of one year, the Exchange may establish an “alternate specialist period” period of less than one year to act as a specialist in an

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<sup>38</sup> The Exchange believes that even if additional floor specialists begin to conduct business on the options floor, Rule 511 was designed for a very different competitive floor environment and is not needed, particularly in light of proposed Rule 510 and the numerous other Exchange rules applicable to options specialists.

<sup>39</sup> See Securities Exchange Act Release No. 77121 (February 11, 2016), 81 FR 8308 (February 18, 2016) (SR-Phlx-2016-22) (notice of filing and immediate effectiveness to delete Rule 505 and update Rule 506).

options class. Rule 508 as proposed discusses the Exchange approval process if there is agreement between or among specialist units to transfer one or more options classes already allocated to a specified specialist unit. Rule 513, which is not proposed to be amended with this filing, discusses the process if an option specialist unit voluntarily resigns from allocation in a particular option and there is a future allocation regarding such option.<sup>40</sup> In addition, Rule 1014 discusses the obligations and restrictions applicable to specialists and registered options traders during each trading day; these obligations and restrictions include, as discussed above, very specific market making requirements. Finally, Rule 1022 discusses securities accounts and orders of specialists and registered options traders and proper identification of accounts, reporting of options, and orders of underlyings.<sup>41</sup>

The Exchange believes that the changes to the noted rules in the Series 500 Rules will make remaining Rules 501, 507, 508, and 510 easier to apply, clearer and better.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>42</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>43</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove

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<sup>40</sup> One rule in the Series 500 Rules does not specifically deal with specialists. This is Rule 507, which was discussed above. This rule deals with the application and approval process for SQTs, RSQTs, or RSQTOs, and the assignment of options.

<sup>41</sup> The Exchange has previously discussed that the allocation and evaluation process in Rule 511 proposed to be deleted made sense when the rule was established with multiple competitive specialists on the floor, but is no longer needed in light of the current composition of the floor.

<sup>42</sup> 15 U.S.C. 78f(b).

<sup>43</sup> 15 U.S.C. 78f(b)(5).

impediments to, and perfect the mechanism of a free and open market and, in general, to protect investors and the public interest by proposing to make changes to five rules in the Series 500 Rules as discussed. The proposed rule change is designed to promote just and equitable principles of trade by updating and modernizing the Series 500 Rules and making them clearer and easier to use while continuing to protect investors and the public interest.

In particular, the Exchange is proposing to change Rule 501 to delete reference to a back-up specialist. With the development of liquidity-enhancing electronic market makers on the Exchange such as RSQTs, which make markets in the same options issues as specialists, and the diminution of the role that the specialist plays in managing the order book on the Exchange, both a back-up specialist and substitute specialist are no longer needed. The Exchange believes that this proposal amendment is consistent with the Act because the advent of streaming quote traders on the Exchange served to perfect the mechanism of a free and open market because of the liquidity that such participants brought to Phlx. These participants are obligated to continuously quote in the market and have filled a role which was previously reliant on a back-up specialist and a substitute specialist.

Obsolete language in Rule 501 in respect of back-up specialists, which includes Commentary .01 to Rule 501, is proposed to be deleted from Rule 501. Similarly, the Exchange is proposing to change Rule 508 to delete the cross reference to Rule 511 and references to “lease.” As discussed, with the change in Rule 510 to the good standing standard that applies to specialists as well as SQTs and RSQTs, Rule 511 is proposed to be deleted and therefore the reference is no longer needed. Moreover, leasing is no

longer permitted on the Exchange, and for this reason the Exchange is proposing to delete this obsolete term from Rule 508. The Exchange believes it is consistent with the Act to delete obsolete references which serve to confuse members within the Rulebook.

The Exchange is proposing to amend Rule 507(a) to permit the Exchange, instead of the Board to defer approval of qualifying applications for SQT or RSQT status pending any action required to address the issue of concern to the Exchange. The applicant would have a right of appeal to the Board or a Board Panel of any action of Exchange staff pursuant to Rule 507(e). The Exchange believes that the application process should be handled by staff initially with appellate rights to the Board or a Board Panel. Currently Rule 507 states that the Board has the ability to perform functions such as deferring or limiting approval of SQTs or RSQTs. The Exchange believes that this amendment is consistent with the Act because it will change will promote just and equitable principles of trade by serving the administration and application of Rule 507 and permitting a right of appeal as provided in Rule 507(e).

With respect to Rule 507(e), the Exchange proposes to expand the appeal to either the Board or a Board Panel. Currently, Rule 507(e) states that an appeal shall be heard by a special committee of the Directors composed of three Directors, of whom at least one (1) shall be an Independent. The Exchange proposes to state that the appeal may be heard by a panel appointed by the Board composed of three (3) members not involved in the Exchange decision appealed from and who otherwise have no conflict of interest. If a panel is appointed by the Board, three persons shall be selected to serve on the panel and in making such selections the Board shall choose individuals whose background, experience and training qualify them to consider and make determinations regarding the

subject matter to be presented to the panel. The panel shall consist of two members of the Exchange, or general partners or officers of member organizations and one other person who would qualify as a public member as defined in Article I of the By-Laws, whom the Board considers to be qualified. The Exchange believes that this amendment is consistent with the Act because the Board or a Board Panel would allow a path of impartial appeal for the applicant.

Also, currently Rule 507(b) states that when making a decision concerning an application for assignment in an option the Exchange shall consider the applicant's prior performance as a specialist, SQT or RSQT based on evaluations conducted pursuant to Exchange Rule 510. The Exchange proposes to update Rule 510 so that in lieu of the current formulaic language in the rule, there is new language that accentuates the good standing of members. In light of this, the Exchange proposes to update the 507(b) reference to state that the Exchange can consider the applicant's prior performance as a specialist, SQT or RSQT based on "good standing pursuant to Rule 510." The Exchange believes that this amendment is consistent with the Act because it will consider a more holistic approach in evaluating members that engage in market making activities. The Exchange believes that this approach is broader and will take new factors into account which would serve to promote just and equitable principles of trade in evaluating market participants that engage in market making activities by considering their obligations and past performance.

The Exchange is proposing to update Rule 510 to give it a new title, "Good Standing for Specialist, SQT, and RSQT," to add relevant good standing language, and appeal rights. The Exchange proposes to amend the language of Rule 510 to indicate

that, with the deletion of Rule 511, Rule 510 will also be applicable to specialists. The Exchange proposes to change the language of Rule 510 to more closely align the Exchange with BX Options by adopting language from the BX Options rule at Chapter VII, Section 4. BX Options Market Makers are held to good standing standards per the BX Options rule. Specialists on Phlx are another type of market maker. The Exchange believes that these amendments are consistent with the Act because these changes serve to add clarity and transparency to the rule text.

The Exchange is adopting language from BX Options at Chapter VII, Section 4. Specifically, the Exchange proposes new language in Rule 510(a) to state that to remain in good standing on the Exchange as a specialist (including Remote Specialist), SQT, or RSQT, the specialist, SQT, or RSQT must meet specific requirements set forth in the rule.<sup>44</sup> As discussed, the proposed new good standing language in Rule 510 will be, in all material respects, similar to BX Options rules at Chapter VII, Section 4. This makes particular sense because all BX Options Market Makers are designated as specialists on BX for all purposes under the Act or rules thereunder and, like Phlx specialists, have market making obligations.<sup>45</sup> The Exchange believes that the good standing rule text is consistent with the Act because as described above the Exchange believes that this approach is broader and will take new factors into account which would serve to promote

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<sup>44</sup> The specific good standing requirements are: i) continue to meet the requirements established in SEC Rule 15c3-1(a)(6)(i), and the requirements set forth in the Series 500 Rules in the Rules of the Exchange; ii) continue to satisfy the specialist, SQT or RSQT qualification requirements specified by the Exchange, as amended from time to time; iii) comply with the Rules of the Exchange and the Options Rules as well as the rules of the Options Clearing Corporation and the rules of the Federal Reserve Board; and iv) pay on a timely basis such member, transaction and other fees as the Exchange shall prescribe. Proposed Rule 510(a).

<sup>45</sup> See, e.g., *supra* note 24 and accompanying discussion.



just and equitable principles of trade in evaluating market participants that engage in market making activities by considering their obligations and past performance.

The Exchange is proposing to add an Informal Meeting process and appeal rights, which do not exist in Rule 510 for specialists; as discussed, the appeal rights now in Rule 510 are regarding SQTs and RSQTs only in respect of performance evaluations. These proposed appeal rights for a specialist (including Remote Specialist), SQT, or RSQT, which are set forth in Rule 510(c) for, are adopted from Rule 511. The memorialization in Rule 510 of Informal Meeting process and appeal rights is done to affirm that if the good standing of a specialist, SQT, or RSQT is suspended, terminated or otherwise withdrawn then they have a clear way to meet with the Exchange to discuss the issue and initiate and prosecute an appeal regarding such decision. The Exchange's proposal to expand the role of the Board to permit an appeal to be heard by a Board Panel appointed by the Board composed of three (3) members not involved in the Exchange decision appealed from and who otherwise have no conflict of interest is consistent with the Act because the Board or a Board Panel would allow a path of impartial appeal for the applicant.<sup>46</sup>

The Exchange has concluded that, with the placement of the good standing concepts into proposed Rule 510 in such a way that they include a specialist (and Remote

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<sup>46</sup> If a Board Panel is appointed by the Board, three persons shall be selected to serve on the Board Panel and in making such selections the Board shall choose individuals whose background, experience and training qualify them to consider and make determinations regarding the subject matter to be presented to the Board Panel. The Board panel shall consist of two members of the Exchange, or general partners or officers of member organizations and one other person that would qualify as a public member as defined in Article I of the By-Laws, whom the Board considers to be qualified.

Specialist), Rule 511 is no longer needed and is therefore proposed to be deleted in its entirety (with transfer of specialist appeal rights from Rule 511 to Rule 510).

The Exchange is proposing to delete Rule 511. This rule was established decades ago for the purpose of dealing with the extensive on-floor open outcry specialist system, with multiple competing specialist units. Since the implementation of Rule 511, the open outcry options floor has evolved into a robust and competitive system that is principally electronic, and the remaining hybrid options floor does not have numerous competing specialists as was the case when Rule 511 was instituted. The Exchange believes that because of the extensive changes on the option floor (from having numerous competitive specialist units on the old options floor to having a specialist unit on the current options floor), and because specialists are proposed to be covered in Rule 510 in terms of good standing and continue to be covered in the Series 500 Rules and other rules of the Exchange, it is consistent with the Act and promotes just and equitable principles of trade to delete Rule 511.

Furthermore, numerous rules in the Phlx Rulebook continue to apply to specialists (as well as to other registered options traders). For example, Rule 501 as proposed discusses the specialist allocation process and specialist approval process. Rule 506 discusses allocation application, reallocation of previously allocated options, and transfer of allocated options. Rule 508 as proposed discusses the Exchange approval process if there is agreement between or among specialist units to transfer one or more options classes already allocated to a specified specialist unit. Rule 513, which is not proposed to be amended with this filing, discusses the process if an option specialist unit voluntarily resigns from allocation in a particular option and there is a future allocation regarding

that option. Rule 1014 discusses the obligations and restrictions, including specific market making requirements, that are applicable to specialists each trading day. Finally, Rule 1022 discusses proper identification of accounts, reporting of options, and orders of underlyings in respect of securities accounts and orders of specialists and ROTs.

The Exchange believes that the changes to the noted rules in the Series 500 Rules will make remaining Rules 501, 507, 508, and 510 easier to apply, clearer and more transparent. Such proposed changes are in consistent with the Act, the public interest, and continue to serve to protect investors.

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

The Exchange 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. While the Exchange does not believe that the proposed change is a burden on competition, or is competitive in nature, the Exchange believes that clearer, updated, modernized, and better-conforming rules that do not refer to obsolete concepts are always beneficial to market participants, are in the public interest, and serve to protect investors.

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

No written comments were either solicited or received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission shall: (a) by order approve or

disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-Phlx-2016-105 on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-Phlx-2016-105. 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-2016-105 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>47</sup>

Robert W. Errett  
Deputy Secretary

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<sup>47</sup> 17 CFR 200.30-3(a)(12).

**EXHIBIT 5**

*Deleted text is bracketed and new text is underlined.*

**NASDAQ PHLX Rules****Rules of the Exchange**

\* \* \* \* \*

**Allocation, SQT, RSQT, and Evaluation Rules (Rules 500—599)**

\* \* \* \* \*

**Rule 501. Specialist Appointment**

(a) No change.

(b) Initial application(s) to become a specialist unit shall be in a form and/or format prescribed by the Exchange and shall include the following: (1) the identity of the unit's staff positions and who will occupy those positions; (2) the unit's clearing arrangements; (3) the unit's capital structure, including any lines of credit; and (4) the unit's back up arrangements endorsed by the parties providing the following support: [a back-up specialist unit not associated with the specialist unit to provide staffing when necessary, and ]a substitute specialist unit not associated with the specialist unit [(which may be the same as the back-up specialist unit)]which shall serve as a substitute specialist unit in the event that the specialist unit is unable to perform the duties of a specialist.

Subsequent applications shall be in a form and/or format prescribed by the Exchange and shall include the information requested therein.

(c) – (e) No change.

(f) An options specialist currently operating from the Exchange's physical trading floor or a Remote Streaming Quote Trader (“RSQT”), as defined in Rule 1014, may submit an application as described above to be approved in one or more classes as a Remote Specialist as defined in Rule 1020(a)(ii).

(i) No change.

(ii) A Remote Specialist does not need to meet the assistant specialist staffing requirement pursuant to paragraph (d) [or the back-up specialist unit requirement pursuant to paragraph (b)]of this rule.

••• *Commentary:* -----

.01 Reserved. [For the purposes of Rule 748(b), individuals employed by the back-up specialist unit will be considered employees of the specialist unit they are assisting.]

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**Rule 507. Application for Approval as an SQT, RSQT, or RSQTO and Assignment in Options**

(a) Approval as an SQT, RSQT, or RSQTO. Registered Options Traders ("ROT"), as defined in Rule 1014, may apply for approval as Streaming Quote Traders ("SQTs") and Remote Streaming Quote Traders ("RSQTs"), as defined in Rule 1014(b)(ii). Member organizations may function as Remote Streaming Quote Trader Organizations ("RSQTOs") pursuant to this rule. RSQTOs may also be referred to as Remote Market Maker Organizations ("RMOs") and RSQTs may also be referred to as Remote Market Markers ("RMMs").

This Rule 507 places no limit on the number of qualifying ROTs that may become SQTs; any applicant that is qualified as an ROT in good standing, and that satisfies the technological readiness and testing requirements described in subsection (b)(ii) below, shall be approved as an SQT. This Rule 507 places no limit on the number of member organizations that are converted to or may become RSQTOs. Any member organization in good standing, and that satisfies the RSQTO readiness and testing requirements described in this rule, shall be approved as an RSQTO. As many as five RSQTs at any time may be identified by and affiliated with an RSQTO. Each of the affiliated RSQTs must be qualified as an ROT and must be in good standing. However, based on system constraints, capacity restrictions or other factors relevant to the maintenance of a fair and orderly market, the Exchange[Board] may defer, for a period to be determined in the [Board]Exchange's discretion, approval of qualifying applications for SQT or RSQT status pending any action required to address the issue of concern to the Exchange[Board]. The Exchange[Board] may not defer a determination of the approval of the application of any SQT or RSQT applicant or place any limitation(s) on access to the Exchange's electronic quoting and trading system on any SQT or RSQT applicant unless the basis for such limitation(s) or deferral have been objectively determined by the Exchange[Board], subject to Securities and Exchange Commission approval or effectiveness pursuant to a rule change filing under Section 19(b) of the Securities Exchange Act of 1934, as amended. The Exchange shall provide written notification to any SQT or RSQT applicant whose application is the subject of such limitation(s) or deferral, describing the objective basis for such limitation(s) or deferral.

RSQTO application. A member organization that is not currently qualified as an RSQTO may apply to the Exchange to be an RSQTO with up to five affiliated RSQTs. Each RSQTO application shall be submitted to the Exchange's designated staff in writing (electronically or otherwise as specified by the Exchange) in a form and/or format prescribed by the Exchange and shall include, at a minimum, the name of the RSQTO

applicant, the appropriate Exchange account number, and the name of each RSQT affiliated with the RSQTO applicant (the “Application Process”).

(i) – (ii) No change.

(b)(i) – (ii) No change.

(iii) In addition to the criteria described in this sub-paragraph, the Exchange shall consider the following factors in making its decision concerning an application for assignment in an option when there are more applicants for assignment in a particular option than there are positions available:

(A) - (B) No change.

(C) the applicant's prior performance as a specialist, SQT or RSQT based on [evaluations conducted pursuant to Exchange] good standing pursuant to Rule 510.

(c) – (d) No change.

(e) An appeal to the Board of Directors from a decision of the Exchange may be requested by a member or member organization interested therein by filing with the Secretary of the Exchange written notice of appeal within ten (10) days after the decision has been rendered. Any appeal from a decision pursuant to Rule 507 shall be heard by [a special committee of] the Board of Directors (“Board”) or a panel appointed by the Board of Directors (“Board Panel”) composed of three (3) [Directors, of whom at least one (1) shall be an Independent.] members not involved in the Exchange decision appealed from and who otherwise have no conflict of interest. If a Board Panel is appointed by the Board, three persons shall be selected to serve on the Board Panel and in making such selections the Board shall choose individuals whose background, experience and training qualify them to consider and make determinations regarding the subject matter to be presented to the Board Panel. The Board Panel shall consist of two members of the Exchange, or general partners or officers of member organizations and one other person who would qualify as a public member as defined in Article I of the By-Laws, whom the Board considers to be qualified. The person requesting review shall be permitted to submit a written statement to and/or appear before this [special committee] Board or Board Panel. The Secretary of the Exchange shall certify the record of the proceeding, if any and the written decision and shall submit these documents to the [special committee] Board or Board Panel. The Board’s or Board Panel’s [special committee's] review of the action shall be based solely on the record, the written decision and any statement submitted by the person requesting the review. The [special committee] Board or Board Panel shall prepare and deliver to such person a written decision and reasons therefore. If the Board or Board Panel [special committee] affirms the action, the action shall become effective ten (10) days from the date of the Board’s or Board Panel’s [special committee's] decision. There shall be no appeal to the Board [of Directors] from any decision of the [special committee] Board Panel.



(f) No change.

••• *Commentary:* -----

.01 - .04 No change.

### **Rule 508. Transfer Application**

Any proposed agreement between or among specialist units to transfer one or more options classes already allocated to a specified specialist unit shall be identified to the Exchange in writing before the proposed transfer. An agreement to transfer [or lease] a specialist unit's options classes may not become effective until approved by the Exchange. Failure to provide the Exchange prior notice of a transfer in accordance with this Rule, or failure to obtain Exchange approval of a transfer, permits the Exchange to recover the allocated securities and reallocate them pursuant to Rule 506[ and 511].

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### **Rule 510. Good Standing for Specialist, SQT, and RSQT [Performance Evaluation]**

(a) To remain in good standing as a specialist (including Remote Specialist), SQT, or RSQT, the specialist, SQT, or RSQT must:

- i. continue to meet the requirements established in SEC Rule 15c3-1(a)(6)(i), and the requirements set forth in the Series 500 Rules in the Rules of the Exchange;
- ii. continue to satisfy the specialist, SQT, or RSQT qualification and market making requirements specified by the Exchange, as amended from time to time;
- iii. comply with the Rules of the Exchange and the Options Rules as well as the rules of The Options Clearing Corporation and the rules of the Federal Reserve Board; and
- iv. pay on a timely basis such member, transaction, and other fees as the Exchange shall prescribe.

(b) The good standing of a specialist (including Remote Specialist), SQT, or RSQT may be suspended, terminated, or otherwise withdrawn, as provided in the Exchange's rules, if any of said conditions for approval cease to be maintained or the specialist, SQT, or RSQT violates any of its agreements with the Exchange or any of the provisions of the Rules of the Exchange or of the Options Rules.

- i. Informal Meeting. The Exchange will provide written notice to a specialist (including Remote Specialist), SQT, or RSQT of a contemplated action regarding good standing pursuant to this Rule 510. A specialist (including Remote Specialist), SQT, or RSQT may request and the Exchange may hold an informal meeting to discuss the alleged failure to remain in good standing and to explore possible

appropriate remedies. Written notice of the date and time of the meeting will be given to the specialist (including Remote Specialist), SQT, or RSQT and no verbatim record will be kept. If the Exchange believes there are no mitigating circumstances that would demonstrate substantial improvement of or reasonable justification for the failure to meet the good standing requirements of this Rule 510, the Exchange may take appropriate action pursuant to subsection (b) of this Rule 510. Nothing in this Informal Meeting process limits the Exchange from bringing disciplinary actions for violations of these rules.

(c) Appeal rights

An appeal by a specialist (including Remote Specialist), SQT, or RSQT to the Board of Directors ("Board") from a decision of the Exchange may be requested by a member or member organization interested therein by filing with the Secretary of the Exchange written notice of appeal within ten (10) days after the decision has been rendered. Any appeal from a decision pursuant to Rule 510 shall be heard by the Board or a panel appointed by the Board of Directors ("Board Panel") composed of three (3) members not involved in the Exchange decision appealed from and who otherwise have no conflict of interest. If a Board Panel is appointed by the Board, three persons shall be selected to serve on the Board Panel and in making such selections the Board shall choose individuals whose background, experience and training qualify them to consider and make determinations regarding the subject matter to be presented to the Board Panel. The Board Panel shall consist of two members of the Exchange, or general partners or officers of member organizations and one other person who would qualify as a public member as defined in Article I of the By-Laws, whom the Board considers to be qualified. The person requesting review shall be permitted to submit a written statement to and/or appear before the Board or Board Panel. The Secretary of the Exchange shall certify the record of the proceeding, if any, and the written decision and shall submit these documents to the Board or Board Panel. The Board's or Board Panel's review of the action shall be based solely on the record, the written decision and any statement submitted by the person requesting the review. The Board or Board Panel shall prepare and deliver to such person a written decision and reasons therefore. If the Board or Board Panel affirms the action, the action shall become effective ten (10) days from the date of the Board's or Board Panel's decision. There shall be no appeal to the Board from any decision of the Board Panel.

[(a) Performance Evaluation. The Exchange will periodically conduct an evaluation of member organizations who have Streaming Quote Traders ("SQTs") and Remote Streaming Quote Traders ("RSQTs"), as defined in Rule 1014, to determine whether they have fulfilled performance standards relating to, among other things, quality of markets, efficient quote submission to the Exchange (including quotes submitted through a third party vendor), competition among market makers, observance of ethical standards, and administrative factors.

(b) Exchange Review of Minimum Performance Standards. The Exchange may review the Performance Evaluations and in addition may consider any other relevant information including, but not limited to, trading data, regulatory history and such other factors and data as may be pertinent in the circumstances. If the Exchange finds any failure by the SQTs and RSQTs to meet Minimum Performance Standards, the Exchange may take the following actions, after written notice and after opportunity for an informal meeting:

- (i) Restriction of assignments to additional (not currently allocated) options;
- (ii) Suspension, termination, or restriction of an assignment in one or more options; or
- (iii) Suspension, termination, or restriction of the SQT's and RSQT's registration in general.

(c) Informal Meeting Following Failure to Meet Minimum Performance Standards. If the Exchange finds any failure by an SQT or RSQT to meet Minimum Performance Standards, the Exchange will provide written notice to the SQT or RSQT. The SQT or RSQT may request and the Exchange may hold an informal meeting with the SQT or RSQT to discuss the failure to meet minimum standards and to explore possible remedies. Written notice of the meeting will be given and no verbatim record will be kept. If, after receiving such notice, the SQT or RSQT refuses or otherwise fails without reasonable justification to meet with the Exchange, the Exchange may refer the matter to the Business Conduct Committee for the commencement of formal disciplinary proceedings pursuant to Rule 960.

If the Exchange believes there are no mitigating circumstances that would demonstrate substantial improvement of or reasonable justification for the failure to meet Minimum Performance Standards, the Exchange may take remedial action pursuant to subsection (b) of this Rule.

(d) An appeal to the Board of Directors from a decision of the Exchange pursuant to subsection (b)(ii) or (b)(iii) of this Rule may be requested by a member or member organization interested therein by filing with the Secretary of the Exchange written notice of appeal within ten (10) days after the decision has been rendered.

(e) If an SQT's or RSQT's assignment in an option has been terminated pursuant to paragraph (b) above, the SQT or RSQT may not be re-appointed as a SQT or RSQT in that option for a period not to exceed six months.

••• *Commentary:* -----

**.01** On a monthly basis, the Exchange will evaluate the following Minimum Performance Standards for each SQT and RSQT:

- (a) Percentage of total quotes that represent the PBBO. If the percentage of the total quotes that represent the PBBO is in the lowest quartile of all SQTs or

RSQTs for two or more consecutive months, this may be considered sub-standard performance (that is, performance that does not attain Minimum Performance Standards).

(b) Quoting requirements pursuant to Rule 1014. If an SQT or RSQT fails to meet the quoting requirements as prescribed by the Rule, this may be considered sub-standard performance (that is, performance that does not attain Minimum Performance Standards).

(c) The number of requests for quote spread parameter relief will also be considered for the purposes of evaluating performance standards.

(d) To evaluate efficient quote submission to the Exchange, the Exchange will utilize both quote-to-trade and quote-to-contracts traded ratios to evaluate how a SQT or RSQT optimizes the submission of quotes submitted to the Exchange pursuant to Rule 1014.

.02 The Exchange may evaluate the first month's SQT or RSQT performance even if it is not a full calendar month.]

**Rule 511. Reserved.[Specialist Allocation and Performance Evaluation**

(a) The Specialist Performance Evaluation standards and procedures contained under this subsection of Rules shall govern Exchange decisions on: (1) allocating new options classes; (2) reallocating options classes for substandard performance; (3) determining whether a specialist unit that has been transferred an options class is performing adequately in order to retain the transferred security; and (4) determining whether a staff reorganization or material change with respect to a specialist unit has affected the ability of the specialist unit to continue to perform adequately in order to retain its securities.

(b) Allocations. The Exchange shall allocate new options classes, approve transfers or reallocate existing options classes to applicants based on the results of such factors as the Exchange deems appropriate, including, but not limited to, Specialist Performance Evaluations or Special Circumstance Evaluations. Among the factors that the Exchange may consider in making such decisions are: the number and type of securities in which applicants are currently registered; the personnel, capital and other resources of the applicant; recent allocation decisions within the past eighteen months; the desirability of encouraging the entry of new specialists into the Exchange's market; order flow commitments; any prior transfers of specialist privileges by the applicant and the reasons therefore and such policies as the Board instructs the Exchange to follow in allocating or reallocating securities. The Exchange may also consider: trade correction data; exemptive relief data; quality of markets data; and observance of ethical standards and administrative responsibilities. Solely with respect to options book allocations or reallocations, past or contemplated voluntary delisting of options books by options specialists, done in the best interest of the Exchange, will not be viewed negatively by the Exchange in making allocation and reallocation decisions. Recognition is given that

evaluation results may not be available for new specialist units or recently reorganized specialist units. The Exchange may establish separate or additional criteria for evaluating new or recently reorganized specialist units, particularly where evaluation results are unavailable or are only available for a limited period of time. All allocations shall initially be made on a temporary basis for a period of up to 180 days within which time the Exchange may commence a Special Circumstance Evaluation. The Exchange is empowered to allocate option classes for a limited period of time or subject to such other terms and conditions as it deems appropriate.

(i) **New Product Specialist Unit Allocation.** When an eligible specialist unit develops or is instrumental in developing or bringing a new product to the Exchange, the Exchange may consider such fact as a conclusive factor in the allocation of the new product and may allocate the new product to such specialist unit without soliciting any other specialist units pursuant to Rule 506. For the purposes of this rule, a new product is anything other than common stock of an operating company, or options or futures on common stock of an operating company or straight debt of an operating company. An operating company, for purposes of this definition, is any issuer other than one which is or holds itself out as being engaged solely in the business of investing in securities; provided that operating company shall include any issuer referred to in Sections 3(b), 3(c)(2)(A), 3(c)(3), 3(c)(5), 3(c)(6), 3(c)(8) or 3(c)(9) of the Investment Company Act of 1940 or Rules 3a-2, 3a-5 and 3a-6 thereunder (17 C.F.R. 270.3a-2; 17 C.F.R. 270.3a-5 and 17 C.F.R. 270.3a-6, respectively).

(ii) **Licensing or Other Acquisition of a Product.** In the case of any options or futures product that involves the licensing or other acquisition of an index, trademark, tradename, patent or other intellectual property, the Exchange may, as a condition of allocating the book, require a specialist unit (i) to indemnify and hold harmless the Exchange and/or any third party against any potential liabilities associated therewith and/or (ii) to pay or undertake to pay the Exchange and/or any third party any amounts related to the licensing of the product or any amounts related to the use of intellectual property; and/or (iii) to enter into any agreement or undertakings with the Exchange and/or any third party otherwise concerning the intellectual property; provided that no such agreement or undertaking shall confer upon such specialist unit any proprietary or ownership rights with respect to such intellectual property or the book. For the purposes of this rule, any requirement that involves that a specialist unit enter into a licensing or other agreement for the acquisition of an index, trademark, tradename, patent or other intellectual property or to indemnify and hold harmless the Exchange and/or any third party against potential liabilities associated therewith and/or to pay or undertake to pay the Exchange or any third party any amounts related to the licensing of a product or any amounts related to the use of intellectual property and/or to enter into any other type of agreement or undertaking with the Exchange or third party is not a business transaction pursuant to Phlx Rule 1023.

(c) **Specialist Performance Evaluations.** The Exchange will at least annually conduct an evaluation of specialist units on the Exchange to determine whether they have fulfilled performance standards that may include, but are not limited to trade correction data,

exemptive relief data, quality of markets data, proper execution of duties as a specialist unit, competition among market makers and in representing the Exchange as a specialist unit, observance of ethical standards, and administrative factors.

In addition to the data in the Specialist Performance Evaluations, the Exchange may also consider any other relevant information including, but not limited to, trading data, regulatory history, the number of requests for quote spread parameter relief, how a specialist unit optimizes the submission of quotes through the Specialized Quote Feed as defined in Rule 1080 by evaluating the number of individual quotes per quote block received by the Exchange, and such other factors and data as may be pertinent in the circumstances.

(d) Minimum Performance Reviews. As part of the Specialist Performance Evaluations, the Exchange will conduct Minimum Performance Reviews on at least an annual basis and may conduct such evaluations as often as on a monthly basis regarding whether specialist units meet Minimum Performance Standards.

(i) Minimum Performance Standards.

(A) The percentage of time that the specialist unit represents or exceeds the PBBO in the options allocated to the unit. If a specialist unit is in the lowest quartile of all specialist units for two or more consecutive months, this may be considered sub-standard performance (that is, performance that does not attain Minimum Performance Standards); and

(B) Fulfillment of quoting requirements pursuant to Rule 1014. If a specialist unit fails to meet the quoting requirements as prescribed by Rule 1014, this may be considered sub-standard performance (that is, performance that does not attain Minimum Performance Standards).

(ii) If the Exchange finds any failure by a specialist unit to meet Minimum Performance Standards, the Exchange may take the following actions, after written notice and after opportunity for an informal meeting:

(A) Restriction of assignments to additional (not currently allocated) options;

(B) Suspension, termination, or restriction of an assignment in one or more options; or

(C) Suspension, termination, or restriction of the specialist unit's or specialist's registration in general.

(iii) Informal Meeting Following Failure to Meet Minimum Performance Standards. If the Exchange finds any failure by a specialist unit to meet Minimum Performance Standards as set forth in this Rule, the Exchange will provide written notice to the specialist unit. The specialist unit may request and the Exchange may hold an

informal meeting with the head specialist and any other appropriate specialist of the specialist unit to discuss the failure to meet minimum standards and to explore possible remedies. Written notice of the meeting will be given and no verbatim record will be kept. If, after receiving such notice, the specialist unit refuses or otherwise fails without reasonable justification to meet with the Exchange, the Exchange may refer the matter to the Business Conduct Committee for the commencement of formal disciplinary proceedings pursuant to Rule 960.

If the Exchange believes there are no mitigating circumstances that would demonstrate substantial improvement of or reasonable justification for the failure to meet Minimum Performance Standards, the Exchange may take remedial action pursuant to subsection (d)(ii) of this Rule.

(iv) An appeal to the Board of Directors from a decision of the Exchange pursuant to subsection (d)(ii)(B) or (d)(ii)(C) of this Rule may be requested by a specialist unit or specialist therein by filing with the Secretary of the Exchange written notice of appeal within ten (10) days after the decision has been rendered.

(v) If a specialist unit's allocation in an option has been terminated pursuant to subsection (d)(i)(A) of this Rule, the specialist unit may not receive a specialist allocation in the terminated option(s) for a period not to exceed six months. If a specialist unit's allocation in an option(s) has been terminated pursuant to subsection (d)(i)(B) of this Rule, the specialist unit may not receive a specialist allocation in the terminated option(s) for a period not to exceed twelve months.

(e) Special Circumstance Evaluations. The Exchange may also conduct Special Circumstance Evaluations whenever there are circumstances that warrant such reviews. This includes, but is not limited to, where the Exchange believes that a specialist unit's performance in a particular market situation was so egregiously deficient as to call into question the Exchange's integrity or impair the Exchange's reputation for maintaining efficient, fair and orderly markets. Special Circumstance Evaluations may incorporate the same review methodology and procedures as established for routine Specialist Performance Evaluations or reviews of Minimum Performance Standards, although Special Circumstance Evaluations may instead or in addition examine such other matters related to a specialist unit's performance as the Exchange deems necessary and appropriate. After a Special Circumstance Evaluation the Exchange may after written notification remove and reallocate one or more securities that were allocated to such specialist unit.

(i) Special Circumstance Evaluations may also include, but are not limited to:

(A) An evaluation within the 180 day period after one or more option classes have been allocated by the Exchange to a specialist unit. Such evaluation will include consideration of whether the specialist unit is complying with the commitments that it made either orally at an appearance before the Exchange or on its written application. If the Exchange determines that the specialist unit has not complied

with any of the commitments that it made when applying for the options class including but not limited to commitments regarding capital, personnel and order flow, the specialist unit will be afforded 30 days in which to comply with such commitments and if it does not do so, the Exchange may, after written notice, remove and reallocate one or more securities that were allocated to such specialist unit.

(B) An evaluation within the 120 day period after a transfer (including a lease) of one or more options classes has become effective or when there has been a material change in the specialist unit. In cases where a head specialist has departed the unit, the evaluation shall also consider the background and ability of the successor head specialist. In the case where a transfer has been effected, the Exchange shall evaluate the performance of the specialist unit with respect to the newly acquired options classes. If the Exchange believes that such performance is inadequate, the specialist unit will be afforded 30 days in which to improve its performance after the Exchange indicates why the performance is inadequate and if it does not do so, the Exchange may, after written notice, remove and reallocate the transferred options classes.

(ii) An appeal to the Board of Directors from a decision of the Exchange pursuant to subsection (e) of this Rule may be requested by a specialist unit or specialist therein by filing with the Secretary of the Exchange written notice of appeal within ten (10) days after the decision has been rendered.

(iii) If a specialist unit's allocation in an option has been terminated pursuant to subsection (e) of this Rule, the specialist unit may not receive a specialist allocation in the terminated option(s) for a period not to exceed six months.

(f) Any appeal from a decision pursuant to Rule 511(d) or (e) shall be heard by a special committee of the Board of Directors composed of three (3) Directors, of whom at least one (1) shall be an Independent. The person requesting review may appeal by filing a written notice thereof with the Secretary of the Exchange within ten (10) days after a decision. The person requesting review shall be permitted to submit a written statement to and/or appear before this special committee. The Secretary of the Exchange shall certify the record of the proceeding, if any and the written decision and shall submit these documents to the special committee. The special committee's review of the action shall be based solely on the record, the written decision and any statement submitted by the person requesting the review. The special committee shall prepare and deliver to such person a written decision and reasons therefor. If the special committee affirms the action, the action shall become effective ten (10) days from the date of the special committee's decision. There shall be no appeal to the Board of Directors from any decision of the special committee.

••• *Supplementary Material:* -----



**.01** For any extension of trading hours contiguous to an existing trading segment, the specialist privileges of the current specialist during that time should automatically and mandatorily be extended to cover the additional trading hours.

**.02** For additional non-contiguous trading segments in any security, or additional types of options, the existing specialist is to be given priority consideration in any allocation proceeding for specialist privileges during the additional time period or covering the additional options.

**.03** In the event the existing specialist applies for but is not granted specialist privileges during the additional trading segment in any security or for the trading of additional types of options, the Exchange shall, in a written decision, show cause for its determination to grant specialist privileges to another specialist.

**.04** Solely with respect to any extension of trading hours for any foreign currency option between the hours of 11 P.M. and 4:30 A.M. Philadelphia Time, a demarcation time shall be established whereby any extension of trading hours and associated specialist trading privileges prior to 3:20 A.M. shall be extended to the evening segment specialist and any extension of trading hours and associated specialist trading privileges after 3:40 A.M. shall be extended to the daytime segment specialist.

**.05** Reference to "specialist unit" within this Rule 511 means the unit as a whole or any subpart of its operation that is acting in a specialist capacity on the Exchange and is subject to evaluation. A specialist unit may have one or more individual "specialists."]

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