

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁸

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-80431; File No. SR-Phlx-2017-27]

Self-Regulatory Organizations; NASDAQ PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Obvious Errors

April 11, 2017.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on April 3, 2017, NASDAQ PHLX LLC (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to amend Rule 1092 (“Current Rule”), entitled “Nullification and Adjustment of Options Transactions including Obvious Errors” by adding a new Commentary .04 to Rule 1092.

The text of the proposed rule change is available on the Exchange’s Web site 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

Last year, the Exchange and other options exchanges adopted a new, harmonized rule related to the adjustment and nullification of erroneous options transactions, including a specific provision related to coordination in connection with large-scale events involving erroneous options transactions.³ The Exchange believes that the changes the options exchanges implemented with the new, harmonized rule have led to increased transparency and finality with respect to the adjustment and nullification of erroneous options transactions. However, as part of the initial initiative, the Exchange and other options exchanges deferred a few specific matters for further discussion.

Specifically, the options exchanges have been working together to identify ways to improve the process related to the adjustment and nullification of erroneous options transactions as it relates to complex orders⁴ and stock-option orders. The goal of the process that the options exchanges have undertaken is to further harmonize rules related to the adjustment and nullification of erroneous options transactions. As described below, the Exchange believes that the changes the options exchanges and the Exchange have agreed to propose will provide transparency and finality with respect to the adjustment and nullification of erroneous complex order and stock-option order transactions. Particularly, the proposed changes seek to achieve consistent results for participants across U.S. options exchanges while maintaining a fair and orderly market, protecting investors and protecting the public interest.

The Proposed Rule is the culmination of this coordinated effort and reflects discussions by the options exchanges whereby the exchanges that offer complex orders and/or stock-option orders will universally adopt new provisions that the options exchanges collectively believe will improve the handling of erroneous options transactions that result from the

execution of complex orders and stock-option orders.⁵

The Exchange believes that the Proposed Rule supports an approach consistent with long-standing principles in the options industry under which the general policy is to adjust rather than nullify transactions. The Exchange acknowledges that adjustment of transactions is contrary to the operation of analogous rules applicable to the equities markets, where erroneous transactions are typically nullified rather than adjusted and where there is no distinction between the types of market participants involved in a transaction. For the reasons set forth below, the Exchange believes that the distinctions in market structure between equities and options markets continue to support these distinctions between the rules for handling obvious errors in the equities and option markets.

Various general structural differences between the options and equities markets point toward the need for a different balancing of risks for options market participants and are reflected in this proposal. Option pricing is formulaic and is tied to the price of the underlying stock, the volatility of the underlying security and other factors. Because options market participants can generally create new open interest in response to trading demand, as new open interest is created, correlated trades in the underlying or related series are generally also executed to hedge a market participant’s risk. This pairing of open interest with hedging interest differentiates the options market specifically (and the derivatives markets broadly) from the cash equities markets. In turn, the Exchange believes that the hedging transactions engaged in by market participants necessitate protection of transactions through adjustments rather than nullifications when possible and otherwise appropriate.

The options markets are also quote driven markets dependent on liquidity providers to an even greater extent than equities markets. In contrast to the approximately 7,000 different securities traded in the U.S. equities markets each day, there are more than 500,000 unique, regularly quoted option series. Given this breadth in options series the options markets are more dependent on liquidity providers than equities markets; such liquidity is provided most commonly by registered market makers

³ See Securities Exchange Act Release No. 76225 (October 22, 2015), 80 FR 66060 (October 28, 2015) (SR-Phlx-2015-86).

⁴ See Rule 1098(a)(i) defining complex orders and stock-option orders.

⁵ An exchange that does not offer complex orders and stock-option orders will not adopt these new provisions until such time as the exchange offers complex orders and/or stock-option orders. The Exchange currently trades complex orders and/or stock-option orders pursuant to Phlx Rule 1098.

¹⁸ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

but also by other professional traders. With the number of instruments in which registered market makers must quote and the risk attendant with quoting so many products simultaneously, the Exchange believes that those liquidity providers should be afforded a greater level of protection. In particular, the Exchange believes that liquidity providers should be allowed protection of their trades given the fact that they typically engage in hedging activity to protect them from significant financial risk to encourage continued liquidity provision and maintenance of the quote-driven options markets. In addition to the factors described above, there are other fundamental differences between options and equities markets which lend themselves to different treatment of different classes of participants that are reflected in this proposal. For example, there is no trade reporting facility in the options markets. Thus, all transactions must occur on an options exchange. This leads to significantly greater retail customer participation directly on exchanges than in the equities markets, where a significant amount of retail customer participation never reaches the Exchange but is instead executed in off-exchange venues such as alternative trading systems, broker-dealer market making desks and internalizers.

In turn, because of such direct retail customer participation, the exchanges have taken steps to afford those retail customers—generally Priority Customers—more favorable treatment in some circumstances.

Complex Orders and Stock-Option Orders

As more fully described below, the Proposed Rule applies much of the Current Rule to complex orders and stock-option orders.⁶ The Proposed Rule deviates from the Current Rule only to account for the unique qualities of complex orders and stock-option orders. The Proposed Rule reflects the fact that complex orders can execute against other complex orders or can execute against individual simple orders in the leg markets. When a complex order executes against the leg markets there may be different counterparties on each leg of the complex order, and not every leg will necessarily be executed at an erroneous price. With regards to stock-option orders, the Proposed Rule reflects the fact that stock-option orders contain a stock component that is

⁶ In order for a complex order or stock-option order to qualify as an obvious or catastrophic error at least one of the legs must itself qualify as an obvious or catastrophic error under the Current Rule. See Proposed Rule 1092.04(a)–(c).

executed on a stock trading venue, and the Exchange may not be able to ensure that the stock trading venue will adjust or nullify the stock execution in the event of an obvious or catastrophic error. In order to apply the Current Rule and account for the unique characteristics of complex orders and stock-option orders, proposed Commentary .04 is split into three parts—paragraphs (a), (b), and (c).

First, proposed Commentary .04(a) governs the review of complex orders that are executed against individual legs (as opposed to a complex order that executes against another complex order).⁷ Proposed Rule 1092.04(a) provides:

If a complex order executes against individual legs and at least one of the legs qualifies as an Obvious Error under paragraph (c)(1) or a Catastrophic Error under paragraph (d)(1), then the leg(s) that is an Obvious or Catastrophic Error will be adjusted in accordance with paragraphs (c)(4)(A) or (d)(3), respectively, regardless of whether one of the parties is a Customer. However, any Customer order subject to this paragraph (a) will be nullified if the adjustment would result in an execution price higher (for buy transactions) or lower (for sell transactions) than the Customer's limit price on the complex order or individual leg(s). If any leg of a complex order is nullified, the entire transaction is nullified.

As previously noted, at least one of the legs of the complex order must qualify as an obvious or catastrophic error under the Current Rule in order for the complex order to receive obvious or catastrophic error relief. Thus, when the Exchange is notified (within the timeframes set forth in paragraph (c)(2) or (d)(2)) of a complex order that is a possible obvious error or catastrophic error, the Exchange will first review the individual legs of the complex order to determine if one or more legs qualify as an obvious or catastrophic error.⁸ If no leg qualifies as an obvious or catastrophic error, the transaction

⁷ The leg market consists of quotes and/or orders in single options series. A complex order may be received by the Exchange electronically, and the legs of the complex order may have different counterparties. For example, Market-Maker 1 may be quoting in ABC calls and Market-Maker 2 may be quoting in ABC puts. A complex order to buy the ABC calls and puts may execute against the quotes of Market-Maker 1 and Market-Maker 2.

⁸ Because a complex order can execute against the leg market, the Exchange may also be notified of a possible obvious or catastrophic error by a counterparty that received an execution in an individual options series. If upon review of a potential obvious error the Exchange determines an individual options series was executed against the leg of a complex order or stock-option order, Proposed Rule 1092.04 will govern.

stands—no adjustment and no nullification.

Reviewing the legs to determine whether one or more legs qualify as an obvious or catastrophic error requires the Exchange to follow the Current Rule. In accordance with paragraphs (c)(1) and (d)(1) of the Current Rule, the Exchange compares the execution price of each individual leg to the Theoretical Price of each leg (as determined by paragraph (b) of the Current Rule). If the execution price of an individual leg is higher or lower than the Theoretical Price for the series by an amount equal to at least the amount shown in the obvious error table in paragraph (c)(1) of the Current Rule or the catastrophic error table in paragraph (d)(1) of the Current Rule, the individual leg qualifies as an obvious or catastrophic error, and the Exchange will take steps to adjust or nullify the transaction.⁹

To illustrate, consider a Customer submits a complex order to the Exchange consisting of leg 1 and leg 2—Leg 1 is to buy 100 ABC calls and leg 2 is to sell 100 ABC puts. Also, consider that Market-Maker 1 is quoting the ABC calls \$1.00–1.20 and Market-Maker 2 is quoting the ABC puts \$2.00–2.20. If the complex order executes against the quotes of Market-Makers 1 and 2, the Customer buys the ABC calls for \$1.20 and sells the ABC puts for \$2.00. As with the obvious/catastrophic error reviews for simple orders, the execution price of leg 1 is compared to the Theoretical Price¹⁰ of Leg 1 in order to determine if Leg 1 is an obvious error under paragraph (c)(1) of the Current Rule or a catastrophic error under paragraph (d)(1) of the Current Rule. The same goes for Leg 2. The execution price of Leg 2 is compared to the Theoretical Price of Leg 2. If it is determined that one or both of the legs are an obvious or catastrophic error, then the leg (or legs) that is an obvious or catastrophic error will be adjusted in accordance with paragraphs (c)(4)(A) or (d)(3) of the Current Rule, regardless of whether one of the parties is a Customer.¹¹ Although a single-legged execution that is deemed to be an obvious error under the Current Rule is nullified whenever a Customer is involved in the transaction, the

⁹ Only the execution price on the leg (or legs) that qualifies as an obvious or catastrophic error pursuant to any portion of Proposed Rule 1092.04 will be adjusted. The execution price of a leg (or legs) that does not qualify as an obvious or catastrophic error will not be adjusted.

¹⁰ See Rule 1092(b) (defining the manner in which Theoretical Price is determined).

¹¹ See Rule 1092(a)(1) (defining Customer for purposes of Rule 1092 as not including a broker-dealer, Professional Customer, or Voluntary Professional Customer).

Exchange believes adjusting execution prices is generally better for the marketplace than nullifying executions because liquidity providers often execute hedging transactions to offset options positions. When an options transaction is nullified the hedging position can adversely affect the liquidity provider. With regards to complex orders that execute against individual legs, the additional rationale for adjusting erroneous execution prices when possible is the fact that the counterparty on a leg that is not executed at an obvious or catastrophic error price cannot look at the execution price to determine whether the execution may later be nullified (as opposed to the counterparty on single-legged order that is executed at an obvious error or catastrophic error price).

Paragraph (c)(4)(A) of the Current Rule mandates that if it is determined that an obvious error has occurred, the execution price of the transaction will be adjusted pursuant to the table set forth in (c)(4)(A). Although for simple orders paragraph (c)(4)(A) is only applicable when no party to the transaction is a Customer, for the purposes of complex orders paragraph (a) of Commentary .04 will supersede that limitation; therefore, if it is determined that a leg (or legs) of a complex order is an obvious error, the leg (or legs) will be adjusted pursuant to (c)(4)(A), regardless of whether a party to the transaction is a Customer. The Size Adjustment Modifier defined in subparagraph (a)(4) will similarly apply (regardless of whether a Customer is on the transaction) by virtue of the application of paragraph (c)(4)(A).¹² The Exchange notes that adjusting all market participants is not unique or novel. When the Exchange determines that a simple order execution is a Catastrophic Error pursuant to the Current Rule, paragraph (d)(3) already provides for adjusting the execution price for all market participants, including Customers.

Furthermore, as with the Current Rule, Proposed Rule 1092.04(a) provides protection for Customer orders, stating that where at least one party to a complex order transaction is a Customer, the transaction will be nullified if adjustment would result in an execution price higher (for buy transactions) or lower (for sell

transactions) than the Customer's limit price on the complex order or individual leg(s). For example, assume Customer enters a complex order to buy leg 1 and leg 2.

- Assume the NBBO for leg 1 is \$0.20–1.00 and the NBBO for leg 2 is \$0.50–1.00 and that these have been the NBBOs since the market opened.

- A split-second prior to the execution of the complex order a Customer enters a simple order to sell the leg 1 options series at \$1.30, and the simple order enters the Exchange's book so that the BBO is \$.20–\$1.30. The limit price on the simple order is \$1.30.

- The complex order executes leg 1 against the Exchange's best offer of \$1.30 and leg 2 at \$1.00 for a net execution price of \$2.30.

- However, leg 1 executed on a wide quote (the NBBO for leg 1 was \$0.20–1.00 at the time of execution, which is wider than \$0.75).¹³ Leg 2 was not executed on a wide quote (the market for leg 2 was \$0.50–1.00); thus, leg 2 execution price stands.

- The Exchange determines that the Theoretical Price for leg 1 is \$1.00, which was the best offer prior to the execution. Leg 1 qualifies as an obvious error because the difference between the Theoretical Price (\$1.00) and the execution price (\$1.30) is larger than \$0.25.¹⁴

- According to Proposed Rule 1092.04(a) Customers will also be adjusted in accordance with Rule 1092(c)(4)(A), which for a buy transaction under \$3.00 calls for the Theoretical Price to be adjusted by adding \$0.15¹⁵ to the Theoretical Price of \$1.00. Thus, adjust execution price for leg 1 would be \$1.15.

- However, adjusting the execution price of leg 1 to \$1.15 violates the limit price of the Customer's sell order on the simple order book for leg 1, which was \$1.30.

- Thus, the entire complex order transaction will be nullified¹⁶ because the limit price of a Customer's sell order would be violated by the adjustment.¹⁷

As the above example demonstrates, incoming complex orders may execute against resting simple orders in the leg market. If a complex order leg is deemed to be an obvious error, adjusting the execution price of the leg may violate the limit price of the resting order,

which will result in nullification if the resting order is for a Customer. In contrast, Rule 1092(d)(1) provides that if an adjustment would result in an execution price that is higher than an erroneous buy transaction or lower than an erroneous sell transaction the execution will not be adjusted or nullified.¹⁸ If the adjustment of a complex order would violate the complex order Customer's limit price, the transaction will be nullified.

As previously noted, paragraph (d)(3) of the Current Rule already mandates that if it is determined that a catastrophic error has occurred, the execution price of the transaction will be adjusted pursuant to the table set forth in (d)(3). For purposes of complex orders under Proposed Rule .04(a), if one of the legs of a complex order is determined to be a Catastrophic Error under paragraph (d)(3), all market participants will be adjusted in accordance with the table set forth in (d)(3). Again, however, where at least one party to a complex order transaction is a Customer, the transaction will be nullified if adjustment would result in an execution price higher (for buy transactions) or lower (for sell transactions) than the Customer's limit price on the complex order or individual leg(s). Again, if any leg of a complex order is nullified, the entire transaction is nullified. Additionally, as is the case today, if it is determined that a Catastrophic Error has not occurred, the Exchange shall take action as set forth in Phlx Rule 1092(e). A member or member organization that submits an appeal seeking the review of the Obvious Error Panel will be assessed a fee of \$500 for each ruling that is overturned. In addition, in instances where the Exchange, on behalf of a Member requests a determination by another market center that a transaction is clearly erroneous, the Exchange will pass any resulting charges through to the relevant Member.

Other than honoring the limit prices established for Customer orders, the Exchange has proposed to treat Customers and non-Customers the same in the context of the complex orders that trade against the leg market. When complex orders trade against the leg market, it is possible that at least some of the legs will execute at prices that would not be deemed obvious or catastrophic errors, which gives the counterparty in such situations no indication that the execution will later be adjusted or nullified. The Exchange believes that treating Customers and non-Customers the same in this context

¹² See Rule 1092(c)(4)(A) (stating that any non-Customer Obvious Error exceeding 50 contracts will be subject to the Size Adjustment Modifier defined in sub-paragraph (a)(4)). The Size Adjustment Modifier may also apply to the option leg of a stock-option order that is adjusted pursuant to Proposed Rule 1092.04(c).

¹³ See Rule 1092(b)(3).

¹⁴ See Rule 1092(c)(1).

¹⁵ See Rule 1092(c)(4)(A).

¹⁶ If any leg of a complex order is nullified, the entire transaction is nullified. See Proposed Rule 1092.04(a).

¹⁷ The simple order in this example is not an erroneous sell transaction because the execution price was not erroneously low. See Rule 1092(a)(2).

¹⁸ See Rule 1092(d)(1).

will provide additional certainty to non-Customers (especially Market-Makers) with respect to their potential exposure and hedging activities, including comfort that even if a transaction is later adjusted, such transaction will not be fully nullified. However, as noted above, under the Proposed Rule where at least one party to the transaction is a Customer, the trade will be nullified if the adjustment would result in an execution price higher (for buy transactions) or lower (for sell transactions) than the Customer's limit price on the complex order or individual leg(s). The Exchange has retained the protection of a Customer's limit price in order to avoid a situation where the adjustment could be to a price that a Customer would not have expected, and market professionals such as non-Customers would be better prepared to recover in such situations. Therefore, adjustment for non-Customers is more appropriate.

Second, proposed Commentary .04(b) governs the review of complex orders that are executed against other complex orders. Proposed Rule 1092.04(b) provides:

If a complex order executes against another complex order and at least one of the legs qualifies as an Obvious Error under paragraph (c)(1) or a Catastrophic Error under paragraph (d)(1), then the leg(s) that is an Obvious or Catastrophic Error will be adjusted or busted in accordance with paragraph (c)(4) or (d)(3), respectively, so long as either: (i) The width of the National Spread Market for the complex order strategy just prior to the erroneous transaction was equal to or greater than the amount set forth in the wide quote table of paragraph (b)(3) or (ii) the net execution price of the complex order is higher (lower) than the offer (bid) of the National Spread Market for the complex order strategy just prior to the erroneous transaction by an amount equal to at least the amount shown in the table in paragraph (c)(1). If any leg of a complex order is nullified, the entire transaction is nullified. For purposes of Rule 1092, the National Spread Market for a complex order strategy is determined by the National Best Bid/Offer of the individual legs of the strategy.

As described above in relation to Proposed Rule 1092.04(a), the first step is for the Exchange to review (upon receipt of a timely notification in accordance with paragraphs (c)(2) or (d)(2) of the Current Rule) the individual legs to determine whether a leg or legs qualifies as an obvious or catastrophic error. If no leg qualifies as an obvious or catastrophic error, the transaction stands—no adjustment and no nullification.

Unlike Proposed Rule 1092.04(a), the Exchange is also proposing to compare the net execution price of the entire

complex order package to the National Spread Market ("NSM") for the complex order strategy.¹⁹ Complex orders are exempt from the order protection rules of the options exchanges.²⁰ Thus, depending on the manner in which the systems of an options exchange are calibrated, a complex order can execute without regard to the prices offered in the complex order books or the leg markets of other options exchanges. In certain situations, reviewing the execution prices of the legs in a vacuum would make the leg appear to be an obvious or catastrophic error, even though the net execution price on the complex order is not an erroneous price. For example, assume the Exchange receives a complex order to buy ABC calls and sell ABC puts.

- If the BBO for the ABC calls is \$5.50–7.50 and the BBO for ABC puts is \$3.00–4.50, then the Exchange's spread market is \$1.00–4.50.²¹
- If the NBBO for the ABC calls is \$6.00–6.50 and the NBBO for the ABC puts is \$3.50–4.00, then the NSM is \$2.00–3.00.
- If the Customer buys the calls at \$7.50 and sells the puts at \$4.50, the complex order Customer receives a net execution price of \$3.00 (debit), which is the expected net execution price as indicated by the NSM offer of \$3.00.

If the exchange were to solely focus on the \$7.50 execution price of the ABC calls or the \$4.50 execution price of the ABC puts, the execution would qualify as an obvious or catastrophic error because the execution price on the legs was outside the NBBO, even though the net execution price is accurate. Thus, the additional review of the NSM to determine if the complex order was executed at a truly erroneous price is necessary. The same concern is not present when a complex order executes against the leg market under Proposed Rule 1092.04(a). Phlx permits a given leg of a complex order to trade through the NBBO provided the complex order

trades no more than a configurable amount outside of the NBBO.²²

In order to incorporate NSM, Rule 1092.04(b) provides that if the Exchange determines that a leg or legs does qualify as an obvious or catastrophic error, the leg or legs will be adjusted or busted in accordance with paragraph (c)(4) or (d)(3) of the Current Rule, so long as either: (i) The width of the NSM for the complex order strategy just prior to the erroneous transaction was equal to or greater than the amount set forth in the wide quote table of paragraph (b)(3) of the Current Rule or (ii) the net execution price of the complex order is higher (lower) than the offer (bid) of the NSM for the complex order strategy just prior to the erroneous transaction by an amount equal to at least the amount shown in the table in paragraph (c)(1) of the Current Rule.

For example, assume an individual leg or legs qualifies as an obvious or catastrophic error and the width of the NSM of the complex order strategy just prior to the erroneous transaction is \$6.00–9.00. The complex order will qualify to be adjusted or busted in accordance with paragraph (c)(4) of the Current Rule because the wide quote table of paragraph (b)(3) of the Current Rule indicates that the minimum amount is \$1.50 for a bid price between \$5.00 to \$10.00. If the NSM were instead \$6.00–7.00 the complex order strategy would not qualify to be adjusted or busted pursuant to .04(b)(i) because the width of the NSM is \$1.00, which is less than the required \$1.50. However, the execution may still qualify to be adjusted or busted in accordance with paragraph (c)(4) or (d)(3) of the Current Rule pursuant to .04(b)(ii). Focusing on the NSM in this manner will ensure that the obvious/catastrophic error review process focuses on the net execution price instead of the execution prices of the individual legs, which may have

²² See Exchange Rule 1098(h)(i), which states "Acceptable Complex Execution ("ACE") Parameter. The ACE Parameter defines a price range outside of which a Complex Order will not be executed. The ACE Parameter is either a percentage or number defined by the Exchange and may be set at a different percentage or number for Complex Orders where one of the components is the underlying security. The ACE Parameter price range is based on the cNBBO at the time an order would be executed. A Complex Order to sell will not be executed at a price that is lower than the cNBBO bid by more than the ACE Parameter. A Complex Order to buy will not be executed at a price that is higher than the cNBBO offer by more than the ACE Parameter. A Complex Order or a portion of a Complex Order that cannot be executed within the ACE Parameter pursuant to this rule will be placed on the CBOOK. The Exchange will issue an Options Trader Alert ("OTA") to membership indicating the issue-by-issue ACE Parameters. The Exchange will also maintain a list of ACE Parameters on its Web site."

¹⁹ For example, if the NBBO of Leg 1 is \$1.00–2.00 and the NBBO of Leg 2 is \$5.00–7.00, then the NSM for a complex order to buy Leg 1 and buy Leg 2 is \$6.00–9.00. See Phlx Rule 1098(a)(vii). NSM is the derived net market for a complex order package.

²⁰ See Rule 1084(b)(viii). All options exchanges have the same order protection rule.

²¹ The complex order is to buy ABC calls and sell ABC puts. The Exchange's best offer for ABC puts is \$7.50 and Exchange's best bid for is \$3.00. If the Customer were to buy the complex order strategy, the Customer would receive a debit of \$4.50 (buy ABC calls for \$7.50 minus selling ABC puts for \$3.00). If the Customer were to sell the complex order strategy the Customer would receive a credit of \$1.00 (selling the ABC calls for \$5.50 minus buying the ABC puts for \$4.50). Thus, the Exchange's spread market is \$1.00–4.50.

execution prices outside of the NBBO of the leg markets.

Again, assume an individual leg or legs qualifies as an obvious or catastrophic error as described above. If the NSM is \$6.00–7.00 (not a wide quote pursuant to the wide quote table in paragraph (b)(3) of the Current Rule) but the execution price of the entire complex order package (*i.e.*, the net execution price) is higher (lower) than the offer (bid) of the NSM for the complex order strategy just prior to the erroneous transaction by an amount equal to at least the amount in the table in paragraph (c)(1) of the Current Rule, then the complex order qualifies to be adjusted or busted in accordance with paragraph (c)(4) or (d)(3) of the Current Rule. For example, if the NSM for the complex order strategy just prior to the erroneous transaction is \$6.00–7.00 and the net execution price of the complex order transaction is \$7.75, the complex order qualifies to be adjusted or busted in accordance with paragraph (c)(4) of the Current Rule because the execution price of \$7.75 is more than \$0.50 (*i.e.*, the minimum amount according to the table in paragraph (c)(1) when the price is above \$5.00 but less than \$10.01) from the NSM offer of \$7.00. Focusing on the NSM in this manner will ensure that the obvious/catastrophic error review process focuses on the net execution price instead of the execution prices of the individual legs, which may have execution prices outside of the NBBO of the leg markets.

Although the Exchange believes adjusting execution prices is generally better for the marketplace than nullifying executions because liquidity providers often execute hedging transactions to offset options positions, the Exchange recognizes that complex orders executing against other complex orders is similar to simple orders executing against other simple orders because both parties are able to review the execution price to determine whether the transaction may have been executed at an erroneous price. Thus, for purposes of complex orders that meet the requirements of Rule 1092.04(b), the Exchange proposes to apply the Current Rule and adjust or bust obvious errors in accordance with paragraph (c)(4) (as opposed to applying paragraph (c)(4)(A) as is the case under .04(a)) and catastrophic errors in accordance with (d)(3).

Therefore, for purposes of complex orders under Proposed Rule 1092.04(b), if one of the legs is determined to be an obvious error under paragraph (c)(1), all Customer transactions will be nullified, unless a member or member organization submits 200 or more

Customer transactions for review in accordance with (c)(4)(C).²³ For purposes of complex orders under Proposed Rule 1092.04(b), if one of the legs is determined to be a catastrophic error under paragraph (d)(3) and all of the other requirements of Rule 1092.04(b) are met, all market participants will be adjusted in accordance with the table set forth in (d)(3). Again, however, pursuant to paragraph (d)(3) where at least one party to a complex order transaction is a Customer, the transaction will be nullified if adjustment would result in an execution price higher (for buy transactions) or lower (for sell transactions) than the Customer's limit price on the complex order or individual leg(s). Also, if any leg of a complex order is nullified, the entire transaction is nullified.

Third, proposed Commentary .04(c) governs stock-option orders.

Proposed Rule 1092.04(c) provides:

If the option leg of a stock-option order qualifies as an Obvious Error under paragraph (c)(1) or a Catastrophic Error under paragraph (d)(1) then the option leg that is an Obvious or Catastrophic Error will be adjusted in accordance with paragraph (c)(4)(A) or (d)(3), respectively, regardless of whether one of the parties is a Customer. However, the option leg of any Customer order subject to this paragraph (c) will be nullified if the adjustment would result in an execution price higher (for buy transactions) or lower (for sell transactions) than the Customer's limit price on the stock-option order, and the Exchange will attempt to nullify the stock leg. Whenever a stock trading venue nullifies the stock leg of a stock-option order or whenever the stock leg cannot be executed, the Exchange will nullify the option leg upon request of one of the parties to the transaction or in accordance with paragraph (c)(3).

Similar to proposed Commentary .04(a), an options leg (or legs) of a stock-option order must qualify as an obvious or catastrophic error under the Current Rule in order for the stock-option order to qualify as an obvious or catastrophic error. Also similar to Proposed Rule 1092.04(a), if an options leg (or legs) does qualify as an obvious or catastrophic error, the option leg (or legs) will be adjusted in accordance with paragraph (c)(4)(A) or (d)(3), respectively, regardless of whether one of the parties is a Customer. Again, as with Proposed Rule 1092.04(a), where at least one party to a complex order transaction is a Customer, the Exchange will nullify the option leg and attempt to nullify the stock leg if adjustment

²³ Rule 1092(c)(4)(C) also requires the orders resulting in 200 or more Customer transactions to have been submitted during the course of 2 minutes or less.

would result in an execution price higher (for buy transactions) or lower (for sell transactions) than the Customer's limit price on the complex order or individual leg(s).

The stock leg of a stock-option order is not executed on the Exchange; rather, the stock leg is sent to a stock trading venue for execution. The Exchange is unaware of a mechanism by which the Exchange can guarantee that the stock leg will be nullified by the stock trading venue in the event of an obvious or catastrophic error on the Exchange. Thus, in the event of the nullification of the option leg pursuant to Proposed Rule 1092.04(c), the Exchange will attempt to have the stock leg nullified by the stock trading venue by either contacting the stock trading venue or notifying the parties to the transaction that the option leg is being nullified. The party or parties to the transaction may ultimately need to contact the stock trading venue to have the stock portion nullified. Finally, the Exchange proposes to provide guidance that whenever the stock trading venue nullifies the stock leg of a stock-option order, the option will be nullified upon request of one of the parties to the transaction or by an Official acting on their own motion in accordance with paragraph (c)(3). There are situations in which buyer and seller agree to trade a stock-option order, but the stock leg cannot be executed. The Exchange proposes to provide guidance that whenever the stock portion of a stock-option order cannot be executed, the Exchange will nullify the option leg upon request of one of the parties to the transaction or on an Official's own motion.

Implementation Date

In order to ensure that other options exchanges are able to adopt rules consistent with this proposal and to coordinate the effectiveness of such harmonized rules, the Exchange proposes to delay the operative date of this proposal to April 17, 2017.

2. Statutory Basis

The Exchange believes that its proposal is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange, and, in particular, with the requirements of Section 6(b) of the Act.²⁴ Specifically, the proposal is consistent with Section 6(b)(5) of the Act²⁵ because it would promote just and equitable principles of trade,

²⁴ 15 U.S.C. 78f(b).

²⁵ 15 U.S.C. 78f(b)(5).

remove impediments to, and perfect the mechanism of, a free and open market and a national market system, and, in general, protect investors and the public interest.

As described above, the Exchange and other options exchanges are seeking to adopt harmonized rules related to the adjustment and nullification of erroneous options transactions. The Exchange believes that the Proposed Rule will provide greater transparency and clarity with respect to the adjustment and nullification of erroneous options transactions. Particularly, the proposed changes seek to achieve consistent results for participants across U.S. options exchanges while maintaining a fair and orderly market, protecting investors and protecting the public interest. Based on the foregoing, the Exchange believes that the proposal is consistent with Section 6(b)(5) of the Act²⁶ in that the Proposed Rule will foster cooperation and coordination with persons engaged in regulating and facilitating transactions.

The Exchange believes the various provisions allowing or dictating adjustment rather than nullification of a trade are necessary given the benefits of adjusting a trade price rather than nullifying the trade completely. Because options trades are used to hedge, or are hedged by, transactions in other markets, including securities and futures, many member and member organizations, and their customers, would rather adjust prices of executions rather than nullify the transactions and, thus, lose a hedge altogether. As such, the Exchange believes it is in the best interest of investors to allow for price adjustments as well as nullifications.

The Exchange does not believe that the proposal is unfairly discriminatory, even though it differentiates in many places between Customers and non-Customers. As with the Current Rule, Customers are treated differently, often affording them preferential treatment. This treatment is appropriate in light of the fact that Customers are not necessarily immersed in the day-to-day trading of the markets, are less likely to be watching trading activity in a particular option throughout the day, and may have limited funds in their trading accounts. At the same time, the Exchange reiterates that in the U.S. options markets generally there is significant retail customer participation that occurs directly on (and only on) options exchanges such as the Exchange. Accordingly, differentiating among market participants with respect

to the adjustment and nullification of erroneous options transactions is not unfairly discriminatory because it is reasonable and fair to provide Customers with additional protections as compared to non-Customers.

The Exchange believes that its proposal to adopt the ability to adjust a Customer's execution price when a complex order is deemed to be an Obvious or Catastrophic Error is consistent with the Act. A complex order that executes against individual leg markets may receive an execution price on an individual leg that is not an Obvious or Catastrophic error but another leg of the transaction is an Obvious or Catastrophic Error. In such situations where the complex order is executing against at least one individual or firm that is not aware of the fact that they have executed against a complex order or that the complex order has been executed at an erroneous price, the Exchange believes it is more appropriate to adjust execution prices if possible because the derivative transactions are often hedged with other securities. Allowing adjustments instead of nullifying transactions in these limited situations will help to ensure that market participants are not left with a hedge that has no position to hedge against.

The Exchange also believes its proposal related to stock-option orders is consistent with the Act. Stock-option orders consist of an option component and a stock component. Due to the fact that the Exchange has no control over the venues on which the stock is executed the proposal focuses on the option component of the stock-option order by adjusting or nullifying the option in accordance with paragraph (c)(4)(A) or (d)(3). Also, nullifying the option component if the stock component cannot be executed ensures that market participants receive the execution for which they bargained. Stock-option orders are negotiated and agreed to as a package; thus, if for any reason the stock portion of a stock-option order cannot ultimately be executed, the parties should not be saddled with an options position sans stock.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. Importantly, the Exchange believes the proposal will not impose a burden on inter-market competition but will rather alleviate any burden on competition because it is the

result of a collaborative effort by all options exchanges to harmonize and improve the process related to the adjustment and nullification of erroneous options transactions.

The Exchange does not believe that the rules applicable to such process is an area where options exchanges should compete, but rather, that all options exchanges should have consistent rules to the extent possible. Particularly where a market participant trades on several different exchanges and an erroneous trade may occur on multiple markets nearly simultaneously, the Exchange believes that a participant should have a consistent experience with respect to the nullification or adjustment of transactions. The Exchange understands that all other options exchanges that trade complex orders and/or stock-option orders intend to file proposals that are substantially similar to this proposal.

The Exchange does not believe that the proposed rule change imposes a burden on intra-market competition because the provisions apply to all market participants equally within each participant category (*i.e.*, Customers and non-Customers). With respect to competition between Customer and non-Customer market participants, the Exchange believes that the Proposed Rule acknowledges competing concerns and tries to strike the appropriate balance between such concerns. For instance, the Exchange believes that protection of Customers is important due to their direct participation in the options markets as well as the fact that they are not, by definition, market professionals. At the same time, the Exchange believes due to the quote-driven nature of the options markets, the importance of liquidity provision in such markets and the risk that liquidity providers bear when quoting a large breadth of products that are derivative of underlying securities, that the protection of liquidity providers and the practice of adjusting transactions rather than nullifying them is of critical importance. As described above, the Exchange will apply specific and objective criteria to determine whether an erroneous transaction has occurred and, if so, how to adjust or nullify a transaction.

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.

²⁶ 15 U.S.C. 78f(b)(5).

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

Because the foregoing proposed rule change does not: (i) Significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A)(iii) of the Act²⁷ and subparagraph (f)(6) of Rule 19b-4 thereunder.²⁸

A proposed rule change filed pursuant to Rule 19b-4(f)(6) under the Act²⁹ normally does not become operative for 30 days after the date of its filing. However, Rule 19b-4(f)(6)(iii)³⁰ permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has asked the Commission to waive the 30-day operative delay so that the proposal may become operative immediately upon filing. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest as it will allow the Exchange to implement the proposed rule change by April 17, 2017 in coordination with the other options exchanges. Accordingly, the Commission hereby waives the operative delay and designates the proposal operative upon filing.³¹

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is: (i) Necessary or appropriate in the public interest; (ii) for the protection of investors; or (iii) otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

²⁷ 15 U.S.C. 78s(b)(3)(A)(iii).

²⁸ 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

²⁹ 17 CFR 240.19b-4(f)(6).

³⁰ 17 CFR 240.19b-4(f)(6)(iii).

³¹ For purposes only of waiving the 30-day operative delay, the Commission has also considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

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 email to rule-comments@sec.gov. Please include File Number SR-Phlx-2017-27 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-2017-27. This file number should be included on the subject line if email 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 Web site 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 such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-Phlx-2017-27, and should be submitted on or before May 8, 2017.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³²

Eduardo A. Aleman,

Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

Proposed Collection; Comment Request

Upon Written Request Copies Available From: Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE., Washington, DC 20549-2736

Extension:

Rule 506(e) of Regulation D Felons and Other Bad Actors Disclosure Statements, OMB Control No.3235-0704, SEC File No. 270-654

Notice is hereby given that, pursuant to the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), the Securities and Exchange Commission ("Commission") is soliciting comments on the collection of information summarized below. The Commission plans to submit this existing collection[s] of information to the Office of Management and Budget for extension and approval.

Rule 506(e) (17 CFR 230.506(e)) of Regulation D under the Securities Act of 1933 (15 U.S.C. 77a *et seq.*) requires the issuer to furnish to each purchaser, a reasonable time prior to sale, a description in writing of any matters that would have triggered disqualification under Rule 506(d)(1) of Regulation D, but occurred before September 23, 2013. The disclosures required by Rule 506(e) is not filed with the Commission, but serves as an important investor protection tool to inform investors of an issuer's and its covered persons, involvement in past "bad actor" disqualifying events such as pre-existing criminal convictions, court injunctions, disciplinary proceedings, and other sanctions enumerated in Rule 506(d). Without the mandatory written statement requirements set forth in Rule 506(e), purchasers may have the impression that all bad actors are disqualified from participation in Rule 506 offerings.

We estimate there are 19,908 respondents that will conduct a one-hour factual inquiry to determine whether the issuer and its covered persons have had pre-existing disqualifying events before September

³² 17 CFR 200.30-3(a)(12).