SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69304; File No. SR-PHLX-2013-005)

April 4, 2013

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Order Granting Approval of Proposed Rule Change Regarding Catastrophic Errors

I. Introduction

On January 31, 2013, NASDAQ OMX PHLX LLC ("PHLX" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to amend Rule 1092, Obvious Errors and Catastrophic Errors. The proposed rule change was published for comment in the Federal Register on February 19, 2013.[3] The Commission received one comment letter on the proposed rule change.[4] This order approves the proposed rule change.

II. Background

The Exchange proposes to amend Rule 1092(f)(ii) to permit the nullification of trades involving catastrophic errors in certain situations. Specifically, the proposed rule would enable a non-broker dealer customer[5] who is the contra-side to a trade that is deemed to be a catastrophic error to have the trade nullified in instances where the adjusted price would violate the customer's limit price. Trades would adjusted in these circumstances if the customer, or his

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

2 17 CFR 240.19b-4.

3 Securities Exchange Act Release No. 68907 (February 12, 2013), 78 FR 11705 ("Notice").

4 See Letter from Ellen Greene, Vice President, Securities Industry and Financial Markets Association to Elizabeth M. Murphy, Secretary, Commission, dated March 14, 2013.

5 The Exchange notes that a professional customer is a customer for purposes of Rule 1092.

agent, affirms the customer's willingness to accept the adjusted price through the customer's limit price within 20 minutes of notification of the catastrophic error ruling.[6]

Under the current rule, and under the rules of all options exchanges, all transactions that qualify as a catastrophic error are adjusted, not nullified. The purpose of the proposal is to help market participants better manage their risk by addressing the situation where, under current rules, a trade can be adjusted to a price outside of a customer's limit price, forcing the customer to spend additional money for a trade that it may not be able to afford. The Exchange notes that this proposal is a fair way to address the issue of a customer's limit price while balancing the competing interests of certainty that trades stand with the policy concerns about dealing with true errors.[7]

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act[8] and the rules and regulations thereunder applicable to a national securities exchange.[9] In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,[10] which requires, among other things, that the Exchange's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with

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6 The Exchange notes that the 20 minute notification period is similar to the time period used currently with respect to triggering the obvious error review process.

7 The Exchanges noted that it is focused on this particular situation because of a recent catastrophic error ruling that resulted in an appeal pursuant to Rule 1092(f)(iv).

8 15 U.S.C. 78f.

9 In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

10 15 U.S.C. 78f(b)(5).

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

The Commission received one comment letter expressing support for the proposed rule change.[11] The commenter believes that the special treatment afforded by the rule change to non-broker-dealer customers is appropriate because, unlike market makers or broker-dealers, non-broker-dealer customers are less likely to be able to absorb the monetary penalty of being forced into a situation where their original limit price is violated.[12] The commenter points to other precedents in the options markets for non-broker-dealer customers getting special treatment for similar reasons to the proposed rule change, namely because they are less active in the markets and often have limited funds in their accounts.[13] Finally, the commenter encourages other options exchanges to adopt similar amendments to their Obvious and Catastrophic Error rules.[14]

The Exchange notes that the proposed rule change is not unfairly discriminatory, even though it offers non-broker dealer customers a choice not provided to other market participants. Specifically, the Exchange notes that the existing obvious error rules differentiate among market participants.[15] The Exchange notes further that customers often are treated specially in the options markets, recognizing that they 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

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[11] See note 4, supra.

[12] Id.

[13] Id.

[14] Id.

[15] The Exchange notes, for example, that the notification period to begin the obvious error process is shorter for specialists and Registered Options Traders than it is for other market participants.

day, and may have limited funds in their trading accounts.[16] The Exchange goes on to note that, while the proposed rule change may introduce uncertainty regarding whether a trade will be adjusted or nullified, it eliminates price uncertainty, as customer orders can be adjusted to significantly different prices than their limit prices under the rule prior to this proposed rule change. For this reason, the Exchange believes that the proposed rule change promotes just and equitable principles of trade and protects investors and the public interest.

The Commission notes that in considering the proposed rule change the Exchange has weighed the benefits of certainty to non-broker-dealer customers that their limit price will not be violated against the costs of increased uncertainty to market makers and broker-dealers that their trades may be nullified instead of adjusted depending on whether the other party to the transaction is or is not a customer.[17] The proposed rule change strikes a similar balance on this issue to the approach taken in the Exchange's Obvious Error Rule, whereby transactions in which an Obvious Error occurred with at least one party as a non-specialist are nullified unless both parties agree to adjust the price of the transaction within 30 minutes of being notified of the Obvious Error.[18] For the reasons noted above, the Commission believes that the proposed rule change is consistent with the Act.

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16 The Exchange notes that customers often have favorable fees relative to other market participants.

17 See Notice, supra note 3.

18 Id.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[19] that the proposed rule change (SR-PHLX-2013-005) is hereby approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[20]

Kevin M. O'Neill
Deputy Secretary

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[19] 15 U.S.C. 78s(b)(2).

[20] 17 CFR 200.30-3(a)(12).