

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-79583; File No. SR-Phlx-2016-104)

December 16, 2016

Self-Regulatory Organizations; NASDAQ PHLX LLC; Order Approving Proposed Rule Change to Amend Phlx Rule 748, Supervision

**I. Introduction**

On October 14, 2016, NASDAQ PHLX LLC (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend several provisions of Rule 748 in order to modernize, upgrade, and strengthen the Exchange’s rules pertaining to supervisory obligations of its members and member organizations.

The proposed rule change was published for comment in the Federal Register on November 3, 2016.<sup>3</sup> The public comment period closed on November 25, 2016. The Commission received no comments in response to the Notice.

This order grants approval of the proposed rule change.

**II. Description of the Proposed Rule Change<sup>4</sup>**

Rule 748(a)

Rule 748(a) currently provides in the first paragraph that each office, location, department, or business activity of a member or member organization (including foreign

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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> See Exchange Act Release No. 79185 (Oct. 28, 2016), 81 FR 76637 (Nov. 3, 2016) (File No. SR-Phlx-2016-104) (“Notice”).

<sup>4</sup> The subsequent description of the proposed rule change is substantially excerpted from the Exchange’s description in the Notice.

incorporated branch offices) shall be under the supervision and control of the member or member organization establishing it and of an appropriately qualified supervisor. The Exchange is amending the first paragraph of Rule 748(a) to clarify and state clearly that each trading system and internal surveillance system of a member or member organization (including foreign incorporated branch offices) shall, inasmuch as they are aspects of their business activity, be under the supervision and control of the member or member organization establishing it and of an appropriately qualified supervisor.

#### Rule 748(b)

Rule 748(b), Designation of Supervisor by Member Organizations, currently provides in relevant part that the general partners or directors of each member organization shall provide for appropriate supervisory control and shall designate a general partner or principal executive officer to assume overall authority and responsibility for internal supervision and control of the organization and compliance with securities' (sic) laws and regulations, including the By-Laws and Rules of the Exchange. It provides that the designated person shall delegate to qualified principals or qualified employees responsibility and authority for supervision and control of each office, location, department, or business activity, (including foreign incorporated branch offices), and provide for appropriate written procedures of supervision and control. The Exchange proposes to amend Rule 748(b) to provide that the delegated person shall likewise delegate to qualified principals or qualified employees responsibility and authority for supervision and control of each trading system and internal surveillance system.<sup>5</sup>

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<sup>5</sup> The Exchange also proposes to delete the extraneous apostrophe following the word "securities."

#### Rule 748(c)

Rule 748(c) currently provides that each person with supervisory control, as described in paragraphs (a) and (b) of Rule 748, must meet the Exchange's qualification requirements for supervisors, including successful completion of the appropriate examination. The Exchange proposes to add to Rule 748(c) a new requirement that each member or member organization must make reasonable efforts to determine that each person with supervisory control, as described in paragraphs (a) and (b) of Rule 748, is qualified by virtue of experience or training to carry out his or her assigned responsibilities.

#### Rule 748(g)

Rule 748(g), Office Inspections, currently provides that each member or member organization for which the Exchange is the Designated Examining Authority shall inspect each office or location (including foreign incorporated branch offices) of the member or member organization according to a cycle that shall be established in its written supervisory procedures. In establishing such inspection cycle, the member or member organization shall give consideration to the nature and complexity of the securities activities for which the office or location is responsible, the volume of business done, and the number of registered representatives, employees, and associated persons at each office or location. Rule 748(g) is proposed to be amended to provide that an inspection may not be conducted by any person within that office or location who has supervisory responsibilities or by any individual who is directly or indirectly supervised by such person. The Exchange also proposes to add language requiring the examination schedule and an explanation of the factors considered in determining the frequency of the examinations in the cycle to be set forth in the member or member organization's written supervisory procedures. It also proposes to require that the inspection be

reasonably designed to assist in preventing and detecting violations of, and achieving compliance with, applicable securities laws and regulations, and with applicable Exchange rules.

Rule 748(h)

Rule 748(h) in the first paragraph currently requires each member or member organization to establish, maintain, and enforce written supervisory procedures, and a system for applying such procedures, to supervise the types of business(es) in which the member or member organization engages and to supervise the activities of all registered representatives, employees, and associated persons. The written supervisory procedures and the system for applying such procedures shall reasonably be expected to prevent and detect, insofar as practicable, violations of the applicable securities laws and regulations, including the By-Laws and Rules of the Exchange. The Exchange proposes to substitute the word “designed” for the word “expected.”

Rule 748(h) in the second paragraph currently requires that the written supervisory procedures set forth the supervisory system established by the member or member organization and include the name, title, registration status, and location of all supervisory personnel required by this rule, the dates for which supervisory designations were or are effective, and the responsibilities of supervisory personnel as these relate to the types of business(es) the member or member organization engages in, and securities laws and regulations, including the By-Laws and Rules of the Exchange. The Exchange proposes to add a requirement that this record be preserved for a period of not less than three years, the first two in an easily accessible place.

Rule 748(h) in the third paragraph currently requires a copy of the written supervisory procedures to be kept and maintained at each location where supervisory activities are conducted on behalf of the member or member organization. It requires each member or member organization to amend its written supervisory procedures as appropriate within a reasonable time

after changes occur in supervisory personnel or supervisory procedures, and to communicate such changes throughout its organization within a reasonable time. The Exchange proposes to amend Rule 748(h) to likewise amend and communicate changes to its written supervisory procedures as appropriate within a reasonable time after changes occur in applicable securities laws and regulations and Exchange rules.

### **III. Comment Summary**

As noted above, the Commission received no comments on the proposed rule change.

### **IV. Discussion and Commission Findings**

The Commission has carefully considered the proposal. Based on its review of the record, the Commission finds that the proposal is consistent with the requirements of the Exchange Act and the rules and regulations thereunder that are applicable to a national securities exchange.<sup>6</sup> Specifically, the Commission finds that the rule change is consistent with Section 6(b)(5) of the Exchange Act,<sup>7</sup> which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

As stated in the Notice, the Exchange believes that “[r]equiring increased comprehensive supervision by members and member organizations of their activities should promote the Exchange’s ability to enforce compliance by members and member organizations with the [Exchange] Act and the regulations thereunder.”<sup>8</sup> With respect to the proposed amendments of

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<sup>6</sup> In approving this rule change, the Commission has considered the rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>7</sup> 15 U.S.C. 78f(b)(5).

<sup>8</sup> Notice at 76638.

Rule 748(a) and (b), the Exchange believes that these amendments “should protect investors and the public interest by specifically requiring supervision and control” of trading systems and internal surveillance systems to be supervised and controlled by “an appropriately qualified individual.”<sup>9</sup> The Exchange believes that the proposed amendments to Rule 748(c) “should protect investors and the public interest by requiring that each person with supervisory control as described in Rules 748(a) and (b) to be qualified by virtue of experience or training to carry out his or her assigned responsibilities, such that the individual has the actual capacity to fulfill those responsibilities.”<sup>10</sup>

Further, the Exchange believes that the proposed amendments to Rule 748(g) will “minimiz[e] the potential for conflicts of interest in the conduct of office inspections” by prohibiting those inspections “from being conducted by any person within that office or location who has supervisory responsibilities or by any individual who is directly or indirectly supervised by such a person who may be incentivized to minimize any compliance issues identified in the inspection.”<sup>11</sup> The Exchange also believes “[t]he proposed amendments to Rule 748(g) concerning the examination schedule and specifically requiring that the inspection be reasonably designed to assist in preventing and detecting violations of, and achieving compliance with, applicable securities laws and regulations and with applicable Exchange rules should assure that inspections take place with a predictable and adequate frequency and are reasonably designed to identify violations of applicable law and rules.”<sup>12</sup>

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<sup>9</sup> Id.

<sup>10</sup> Id.

<sup>11</sup> Id. at 76638-39.

<sup>12</sup> Id. at 76639.

The Exchange believes that the proposed amendments to Rule 748(h), which address the design and maintenance of written supervisory procedures, will “facilitate identification of instances where the procedures were not followed” and also “clarif[y] the affirmative nature of the member or member organization’s obligations under the rule when creating such procedures.”<sup>13</sup> Finally, the Exchange believes that the proposed amendment to Rule 748(h) with respect to updating written supervisory procedures “should promote the continued usefulness of the procedures in the context of ongoing changes in the regulatory environment in which members and member organizations conduct their business.”<sup>14</sup>

The Commission notes that the proposal received no comments from the public. Taking into consideration the Exchange’s views about the proposed amendments, the Commission believes that the proposal will help protect investors and the public interest by strengthening and clarifying the supervisory obligations of Exchange members and member organizations. The Commission believes that the approach proposed by the Exchange is appropriate and designed to protect investors and the public interest, consistent with Section 6(b)(5) of the Exchange Act. For these reasons, the Commission finds that the proposed rule change is consistent with the Exchange Act and the rules and regulations thereunder.

**V. Conclusion**

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2)<sup>15</sup> of the Exchange Act,<sup>16</sup>

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<sup>13</sup> Id.

<sup>14</sup> Id.

<sup>15</sup> Id.

<sup>16</sup> 15 U.S.C. 78s(b)(2).

that the proposed rule change (SR-Phlx-2016-104) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>17</sup>

Eduardo A. Aleman  
Assistant Secretary

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