

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57653; File No. SR-NYSEArca-2008-41)

April 11, 2008

Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Amending Rule 6.87 to Include Procedures for Handling Catastrophic Errors

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 8, 2008, NYSE Arca, Inc. (“NYSE Arca” 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 substantially prepared by the Exchange. The Exchange filed the proposal as a “non-controversial” proposed rule change pursuant to Section 19(b)(3)(A)³ of the Act and Rule 19b-4(f)(6) thereunder,⁴ which renders the proposal effective upon filing with the Commission. 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 NYSE Arca Rule 6.87 to include procedures for handling Catastrophic Errors. The Exchange also proposes to revise the methodology used for determining the theoretical value of an option, as used in Rule 6.87. The text of the proposed rule change is available at the Exchange, the Commission’s Public Reference Room, and www.nysearca.com.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

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. NYSE Arca 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 states that the purpose of the proposed rule change is to amend NYSE Arca Rule 6.87 to add provisions for price adjustment under certain extreme circumstances. In particular, the Exchange proposes to add criteria for identifying "Catastrophic Errors," and making adjustments when Catastrophic Errors occur, as well as a streamlined procedure for reviewing actions taken in these extreme circumstances. The Exchange is also proposing revisions to Rule 6.87 related to: (i) determining the theoretical price of an option; and (ii) formatting and making non-substantive changes involving certain language contained in existing rule text.

Catastrophic Error Proposal

The Exchange notes that, currently under Rule 6.87, the Exchange's Obvious Error Rule, trades that result from an Obvious Error may be adjusted or busted according to objective standards. Under the rule, whether an Obvious Error has occurred is determined by comparing the execution price to the theoretical price of the option. The rule generally requires that OTP

Holder⁵ notify the Exchange within a short time period following the execution of a trade (five minutes for Market Makers and twenty minutes for non-Market Makers) if they believe the trade qualifies as an Obvious Error. Trades that qualify for adjustment are adjusted under the rule to a price that matches the theoretical price plus or minus an adjustment value, which is \$.15 if the theoretical value is under \$3 and \$.30 if the theoretical value is at or above \$3. By adjusting trades above or below the theoretical price, the rule assesses a “penalty” in that the adjustment price is not as favorable as what the party making the error would have received had it not made the error.

In formulating the Obvious Error Rule, the Exchange states that it has weighed carefully the need to assure that one market participant is not permitted to receive a wind-fall at the expense of another market participant that made an Obvious Error, against the need to assure that market participants are not simply being given an opportunity to reconsider poor trading decisions. The Exchange states that, while it believes that the Obvious Error Rule strikes the correct balance in most situations, in some extreme situations, trade participants may not be aware of errors that result in very large losses within the time periods required under the rule. In this type of extreme situation, NYSE Arca believes OTP Holders should be given more time to seek relief so that there is a greater opportunity to mitigate very large losses and reduce the corresponding large wind-falls. However, to maintain the appropriate balance, the Exchange believes OTP Holders should only be given more time when the execution price is much further

⁵ The Exchange states that “members” refers to OTP Holders. For clarity, “member” has been replaced with “OTP Holder” throughout the filing. Telephone conversation between Glenn H. Gsell, Managing Director, NYSE Regulation, Exchange and Michou H.M. Nguyen, Special Counsel, Division of Trading and Markets, Commission on April 10, 2008.

away from the theoretical price than is required for Obvious Errors, and that the adjustment “penalty” should be much greater, so that relief is only provided in extreme circumstances.⁶

Accordingly, the Exchange proposes to establish a new paragraph (b) to Rule 6.87 to address “Catastrophic Errors.” Under the proposed rule, OTP Holders will have until 8:30 a.m. Eastern Time on the day following the trade to notify the Exchange of a potential Catastrophic Error. For trades that take place in an expiring series on the day of expiration, OTP Holders must notify the Exchange of a potential Catastrophic Error by 5 p.m. Eastern Time that same day. Once an OTP Holder has notified the Exchange of a potential Catastrophic Error, within the required time period, a three-person panel (“Catastrophic Error Review Panel”) would review and make a determination as to the claim. The Catastrophic Error Review Panel (“Panel”), as described in proposed Rule 6.87(b)(3)(C), would be comprised of the NYSE Arca Chief Regulatory Officer (“CRO”), or a designee of the CRO, and a representative from two different OTP Firms. One representative on the Panel would always be from an OTP Firm directly engaged in market making activities, and one representative on the Panel would always be from an OTP Firm directly engaged in the handling of options orders for public customers.⁷ The Exchange feels that having a three-person panel, of which the majority is made up of individuals

⁶ The Exchange does not believe the type of extreme situation that is covered by the proposed rule would occur in the normal course of trading. Rather, this type of situation could potentially occur as a result of, for example, an error in a OTP Holder’s quotation system that causes a market maker to severely misprice an option.

⁷ The Exchange states that the composition of the Catastrophic Error Review Panel is similar to that of the NYSE Arca Obvious Error Panel, as defined in Rule 6.87(a)(4)(A)(i).

from OTP Holder firms, will help ensure that Catastrophic Error determinations are made by a diverse, representative group in a manner that fosters fairness and impartiality.

The Exchange shall designate at least ten OTP Firm representatives to be called upon to serve on the Panel, as needed. In no case shall a Panel include a person related to a party to the trade in question. To the extent reasonably possible, the Exchange shall call upon the designated representatives to participate in a Panel on an equally-frequent basis.

In the event the Panel determines that a Catastrophic Error did not occur, the OTP Holder that initiated the review would be charged \$5,000 to reimburse the Exchange for the costs associated with reviewing the claim. All determinations by the Catastrophic Error Review Panel would constitute final Exchange action on the matter at issue.

A Catastrophic Error would be deemed to have occurred when the execution price(s) of a transaction(s) is higher or lower than the theoretical price for the option by an amount equal to at least the amount shown in the second column of the chart below (the “Minimum Amount”), and the adjustment(s) would be made plus or minus the amount(s) shown in column three of the chart below (the “Adjustment Value”). At all price levels, the Minimum Amount and the Adjustment Value for Catastrophic Errors would be significantly higher than for Obvious Errors, which the Exchange believes, would limit the application of the proposed rule to situations where the losses are very large.

Theoretical price	Minimum Amount	Adjustment Value
Below \$2	\$1	\$1
\$2 to \$5	\$2	\$2
Above \$5 to \$10	\$5	\$3
Above \$10 to \$50	\$10	\$5
Above \$50 to \$100	\$20	\$7
Above \$100	\$30	\$10

The following example demonstrates how the proposed Catastrophic Error provisions would operate within the Obvious Error framework. Assume an OTP Holder notifies the Exchange within two minutes of a trade where 100 contracts of an option with a theoretical price of \$9 were purchased for \$17, resulting in an \$80,000 error.⁸ The trade would qualify as an Obvious Error because the purchase price is more than \$.50 above the theoretical price and the OTP Holder notified the Exchange within the required time period. The Exchange would review the trade and either bust it or adjust it to a purchase price of \$9.30,⁹ which reduces the cost of the error to \$3,000.¹⁰ If, however, the OTP Holder failed to identify the same error and notify the Exchange until four hours after the trade, it could not be reviewed under the current Obvious Error Rule. Under the proposal, this trade would qualify as a Catastrophic Error because the purchase price is more than \$5 above the theoretical price. Under the proposal, the Panel would

⁸ One hundred contracts equal 10,000 shares, and the purchase price is \$8 per share above the theoretical price. Therefore, the purchaser paid \$80,000 over the theoretical value.

⁹ NYSE Arca Rule 6.87(a)(3)(B).

¹⁰ 10,000 shares at \$.30 per share over the theoretical value.

review the trade and adjust the purchase price to \$12, which reduces the cost of the error to \$30,000.¹¹

The Exchange believes that the proposed longer time period is appropriate to allow OTP Holders to discover, and seek relief from, trading errors that result in extreme losses. At the same time, the Exchange believes that the proposed Minimum Amounts required for a trade to qualify as a Catastrophic Error, in combination with the large Adjustment Values, assures that only those transactions where the price of the execution results in very high losses will be eligible for adjustment under the new provisions. While the Exchange believes it is important to identify and resolve trading errors quickly, it also believes it is important to the integrity of the marketplace to have the authority to mitigate extreme losses resulting from errors. In this respect, the Exchange believes that the above example illustrates how market participants would continue to be encouraged to identify errors quickly, as losses will be significantly lower if the erroneous trades are busted or adjusted under the Obvious Error provisions of the rule.

In consideration of the extreme nature of situations that will be addressed under the proposed Catastrophic Error provisions, the Exchange proposes a streamlined procedure for making determinations and adjustments. Under the current rule for Obvious Errors, exchange staff makes determinations that can then be appealed to the Obvious Error Appeal Panel (“OE Panel”). For Catastrophic Errors, the Exchange proposes to have a one-step process where the Catastrophic Error Review Panel makes determinations and adjustments. Additionally, given the burden that reviews under the Catastrophic Error provisions of the rule would have on exchange staff and OTP Holder representatives, the Exchange proposes to include a \$5,000 fee in the event that the Panel determines that a Catastrophic Error did not occur. The Exchange believes that

¹¹ 10,000 shares at \$3.00 per share over the theoretical value.

this is reasonable to encourage OTP Holders and OTP Firms to requests reviews only in appropriate situations, particularly given the objective criteria used to determine whether a Catastrophic Error occurred and the considerable amount of time participants are given under the proposal to assess whether a trade falls within those criteria.

Obvious Error Revisions

Existing Rule 6.87(a)(2)(A) - (B) describes procedures for determining the theoretical value of an option based on the last bid price with respect to an erroneous sell transaction and the last offer price with respect to an erroneous buy transaction, just prior to the trade, disseminated by the competing options exchange that has the most liquidity in that option, or if there are not quotes for comparison purposes, as determined by designated personnel of the Exchange. NYSE Arca now proposes two changes of this rule:

(1) In lieu of using the best bid or offer from a single competing options exchange when determining the theoretical price of an option, the Exchange would now use the last bid price or the last offer price, just prior to the trade, that comprise the National Best Bid/Offer (“NBBO”)¹² as disseminated by the Options Price Reporting Authority (“OPRA”). By using the NBBO prices, the Exchange would be able to more accurately calculate the theoretical price of an option.

(2) In the event that there are no quotes for comparison, the determination of the theoretical price is presently made by designated personnel of the Exchange. The Exchange now

¹² NYSE Arca notes that the Philadelphia Stock Exchange (“Phlx”), see Phlx Rule 1092(b), and the American Stock Exchange (“Amex”), see Amex Rule 936-ANTE, use the midpoint of the NBBO to determine the theoretical price of an option.

proposes that in the event that there are no quotes for comparison, the determination would be made by a designated Trading Official.¹³

The Exchange also proposes to delete existing Commentaries .05 and .06 to Rule 6.87. Commentary .05 refers to Rule 6.87(a)(2)(A) and deals with the competing options exchange with the most liquidity in an option series. This information would no longer be relevant, pursuant to proposed changes to Rule 6.87(a)(2)(A) as part of this filing. Existing Commentary .06 would be deleted and the relevant rule text incorporated into proposed Commentary .02.

The Exchange is also proposing at this time to correct a typographical error in the commentary section of Rule 6.87. Commentaries .07 and .08¹⁴ incorrectly reference Rule 6.78, instead of Rule 6.87. The Exchange states that this was simply a case of transposed numbers and that the change would have no bearing on the interpretation of the actual rule.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,¹⁵ in general, and furthers the objectives of Section 6(b)(5) of the Act,¹⁶ in particular, in that it is designed to prevent fraudulent and manipulative acts, 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. In particular, the proposal would allow OTP Holders a longer opportunity to seek relief from errors that result in large losses. Also, adopting the NBBO

¹³ The Exchange states that a Trading Official, as defined in Rule 6.1(b)(34), is an Exchange employee or officer, who is designated by the Chief Executive Officer or his designee or by the Chief Regulatory Officer or his designee. Exchange employees or officers designated as Trading Officials recommend and enforce rules and regulations relating to trading, decorum, health, safety, and welfare on the Exchange.

¹⁴ Under this proposal, current Commentaries .07 and .08 are being renumbered .05 and .06.

¹⁵ 15 U.S.C. 78f(b).

¹⁶ 15 U.S.C. 78f(b)(5).

market for use when determining the theoretical price of an option, assures that any price adjustments made to Obvious or Catastrophic Errors will not violate the terms of the Options Intermarket Linkage Plan.¹⁷

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

The Exchange does not believe that the proposed rule change would impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

The Exchange has neither solicited nor received written comments on the proposed rule change.

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

Because the 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 after the date of filing (or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest), the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁸ and subparagraph (f)(6) of Rule 19b-4 thereunder.¹⁹

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative prior to 30 days after the date of filing.²⁰ However, Rule 19b-4(f)(6)(iii) permits the Commission to designate a shorter time if such action is consistent with the protection of

¹⁷ See Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000) (File No. 4-429) (order approving the Options Intermarket Linkage Plan).

¹⁸ 15 U.S.C. 78s(b)(3)(A).

¹⁹ 17 CFR 240.19b-4(f)(6).

²⁰ 17 CFR 240.19b-4(f)(6)(iii). The Exchange has satisfied the five-day pre-filing requirement of Rule 19b-4(f)(6)(iii).

investors and the public interest. The Exchange has requested that the Commission waive the 30-day operative delay and designate the proposed rule change operative upon filing. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest. Given that the Exchange's proposed catastrophic error relief is substantially the same as that of the International Securities Exchange ("ISE"), previously approved by the Commission,²¹ the proposal does not appear to present any novel regulatory issues. In addition, waiving the 30-day operative delay ensures that the Exchange's obvious error rule conforms to the Options Intermarket Linkage Plan without delay. Therefore, the Commission designates the proposal operative upon filing.²²

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in the furtherance of the purposes of the Act.

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

²¹ See Securities Exchange Act Release No. 57398 (February 28, 2008), 73 FR 12240 (March 6, 2008) (order approving SR-ISE-2007-112).

²² For purposes only of waiving the operative delay of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NYSEArca-2008-41 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-NYSEArca-2008-41. 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 inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. 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-NYSEArca-2008-41 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.²³

Florence E. Harmon
Deputy Secretary

²³ 17 CFR 200.30-3(a)(12).