

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-62147; File No. SR-Phlx-2010-43)

May 21, 2010

Self-Regulatory Organizations; NASDAQ OMX PHLX, Inc.; Order Approving a Proposed Rule Change Relating to Quote Spread Parameters and Batching of Violations

On March 26, 2010, NASDAQ OMX PHLX, Inc. (“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”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change relating to quote spread parameters and batching of violations. The proposed rule change was published for comment in the Federal Register on April 16, 2010.<sup>3</sup> The Commission did not receive any comment letters on the proposed rule change. This order approves the proposed rule change.

The Exchange proposed to update Advice F-6 to reflect language requiring options quoted electronically to be quoted with a \$5 quote spread after the opening that was previously inadvertently omitted from Advice F-6. With respect to the proposed changes to Advice F-6, the Exchange represented that those who are quoting verbally (in open outcry) must, throughout the trading day, comply with the regular quote spread parameters that apply at the opening. The language of quote spreads not exceeding \$5 after the opening for those quoting options electronically was inadvertently not incorporated into Advice F-6 in a previous rule filing.<sup>4</sup> The

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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 Securities Exchange Act Release No. 61862 (April 16, 2010), 75 FR 20016.

<sup>4</sup> See Securities Exchange Act Release No. 50728 (November 23, 2004), 69 FR 69982 (December 1, 2004) (SR-Phlx-2004-74).

Exchange proposed to correct this oversight by inserting this language regarding electronically quoted options into Advice F-6.

The Exchange also proposed to amend the Exchange's fine schedule applicable to Advice F-6, which is administered pursuant to the Exchange's minor rule plan ("MRP"). As amended, the fine schedule would now consist of Warning Letters for the first three violations, and three fines thereafter (\$250, \$500 and \$1,000). A seventh violation would result in referral to the Exchange's Business Conduct Committee ("BCC") for disciplinary action. In addition, the Exchange proposed that the fine schedule would be administered on a one-year running calendar basis, such that violations within one year of the last "occurrence" would count as the next "occurrence." Currently, the fine schedule is administered on a two-year running calendar basis.

Finally, the Exchange proposed amendments to Rules 960.2 and 970 to permit the aggregation or "batching" of quote spread parameter violations. Phlx notes that quoting on the Exchange has become entirely electronic; thus, when there is a quoting error, the error can affect every series that a firm is quoting, generating multiple instances of quote spread violations. The Exchange believes that, rather than taking each event to the BCC as a fourth violation under the current rule, such violations should be batched together and treated as one violation. This way, pursuant to the revised rules, the firm would receive a warning letter for the first three batched violations before being subject to a monetary fine. The Exchange further noted that it could, in any particular situation, deem the violations to be egregious rather than "minor" and refer the matter directly to the BCC for disciplinary action. The Exchange believes that this approach is appropriate because the relevant warning letters or monetary fines should serve as a deterrent against future violations, while recognizing that a single programming error can have a widespread effect. In addition, the Exchange believes that Advice F-6 (and its corresponding

rule) is appropriate for batching because the automated surveillance for quote spread parameter compliance,<sup>5</sup> as well as the issuance of sanctions pursuant to the minor rule plan,<sup>6</sup> will be conducted daily.

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>7</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>8</sup> which requires, among other things, that the rules of a national securities exchange be designed to promote just and equitable principles of trade, 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 also believes that the proposal is consistent with Sections 6(b)(1) and 6(b)(6) of the Act,<sup>9</sup> which require that the rules of an exchange enforce compliance with, and provide appropriate discipline for, violations of Commission and Exchange rules. Furthermore, the Commission believes that the proposed changes to the MRP should strengthen the Exchange's ability to carry out its oversight and enforcement responsibilities as a self-regulatory organization in cases where full disciplinary proceedings are unsuitable in view of the minor nature of the particular violation. In

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<sup>5</sup> Confidential letters from Stephen M. Pettibone, Managing Director Surveillance, Phlx, to Michael Gaw, Assistant Director, Division of Trading and Markets, and Tina Barry, Assistant Director, Office of Compliance Inspections and Examinations, Commission, dated October 6, 2009 and December 30, 2009.

<sup>6</sup> See letter from Charles Rogers, Chief Regulatory Officer, Phlx, to Tina Barry, Assistant Director, Office of Compliance Inspections and Examinations and Michael Gaw, Assistant Director, Division of Trading and Markets, Commission, dated February 18, 2010.

<sup>7</sup> In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

<sup>9</sup> 15 U.S.C. 78f(b)(1) and 78f(b)(6).

addition, the Commission finds that the proposal is consistent with the public interest, the protection of investors, or otherwise in furtherance of the purposes of the Act, as required by Rule 19d-1(c)(2) under the Act,<sup>10</sup> which governs minor rule violation plans.

The Commission believes that the Exchange's proposal to amend Advice F-6 to add rule text referencing quote spread parameters for options that are quoted electronically is appropriate because the text was inadvertently omitted. In addition, the Commission believes that batching of violations of the quote spread parameter rule, under the MRP, reasonably addresses quoting violations on an electronic market, where one inadvertent error can potentially result in multiple quotes that fall outside the quote spread parameters.

The Exchange has represented it will conduct automated surveillance for quote spread parameter compliance on a daily basis, and will issue sanctions for quote spread violations pursuant to the MRP also on a daily basis. The Commission further notes that pursuant to Rules 960.2(f)(ii) and 970.01, the batching program will continue to require that the violations be determined based on an exception-based surveillance program. Any further proposal by the Exchange to permit the batching of violations of any Exchange rule would be subject to Commission approval.

In approving this proposed rule change, the Commission in no way minimizes the importance of compliance with Exchange rules and all other rules subject to the imposition of fines under the MRP. The Commission believes that the violation of any self-regulatory organization's rules, as well as Commission rules, is a serious matter. However, the MRP provides a reasonable means of addressing rule violations that do not rise to the level of requiring formal disciplinary proceedings, while providing greater flexibility in handling certain violations.

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<sup>10</sup> 17 CFR 240.19d-1(c)(2).

The Commission expects that the Exchange will continue to conduct surveillance with due diligence and make a determination based on its findings, on a case-by-case basis, whether a fine of more or less than the recommended amount is appropriate for a violation under the MRP, whether it might not be appropriate to batch a series of actions as a single violation under the MRP, or whether a violation or series of violations may require formal disciplinary action.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act<sup>11</sup> and Rule 19d-1(c)(2) under the Act,<sup>12</sup> that the proposed rule change (SR-Phlx-2010-43) be, and hereby is, approved and declared effective.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>13</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>11</sup> 15 U.S.C. 78s(b)(2).

<sup>12</sup> 17 CFR 240.19d-1(c)(2).

<sup>13</sup> 17 CFR 200.30-3(a)(12) and 200.30-3(a)(44).