

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-62776; File No. SR-Phlx-2010-91)

August 26, 2010

Self-Regulatory Organizations; NASDAQ OMX PHLX, Inc.; Order Approving Proposed Rule Change, as Modified by Amendment No. 1 Thereto, to Amend Phlx Rule 604 Relating to Registration and Qualification Requirements for PSX

I. Introduction

On June 29, 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”)¹ and Rule 19b-4 thereunder,² a proposed rule change to adopt provisions relating to the registration and qualification of members and persons associated with member organizations. On July 13, 2010, the Exchange submitted Amendment No. 1 to the proposed rule change. The proposed rule change was published for comment in the Federal Register on July 22, 2010.³ The Commission received no comment letters on the proposal. This order approves the proposed rule change, as modified by Amendment No. 1.

II. Description of the Proposal

Phlx proposes to amend Rule 604, “Registration and Termination of Registered Persons,” to adopt new and modify existing provisions governing general and limited categories of principals and representatives. The proposal is meant to capture all persons associated with member organizations who trade on the Exchange’s new equity platform, NASDAQ OMX PSX (“PSX”). Specifically, the Exchange proposes to adopt Rule 604(g), “Principal Registration,” and Supplementary Material .01 - .03 to set forth the categories of principal registration. The

¹ 15 U.S.C 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 62509 (July 15, 2010), 75 FR 42804.

rule would require, among other things, that all associated persons who perform certain functions pass an appropriate examination and register as principals; every member organization to have at least two registered principals (unless an exception applies); and each member organization to have a Limited Principal - Financial/Operations. In addition, Phlx Rule 604(h) and Supplementary Material .04 would require that each representative be registered and pass the General Securities Representative Examination (“Series 7”).

Phlx also proposes to adopt Phlx Rule 604(i)(1) to delineate categories of persons that are exempt from registration, Rule 604(i)(2) to allow member organizations and persons associated with member organizations to pay to non-registered foreign persons transaction-related compensation based upon business of customers they direct to member organizations if certain conditions are met, and Phlx Rule 604(j) to allow for waiver of qualification examination requirements in exceptional circumstances. In connection with the above amendments, Phlx proposes to add several related terms to Rule 1, “Definitions.” Finally, Phlx proposes to amend Rule 640, “Continuing Education for Registered Persons,” to delete an outdated reference.

Applicability – Rule 604(f)

Proposed Phlx Rule 604(f) would state that sub-paragraphs (g) and (h), discussed in greater detail below, apply to member organizations, and associated persons of member organizations, that are registered with the Exchange for the purpose of trading NMS stocks.⁴

Principal Registration – Rule 604(g)

Proposed Phlx Rule 604(g) would provide that persons associated with a member organization who are actively engaged in the management of the member organization's

⁴ PSX will not be used for trading any securities other than NMS stocks. Existing rules would continue to govern registration of associated persons of member organizations that trade options, but not cash equities, through Phlx. The Commission understands that Phlx intends to amend its registration rules for its options members shortly.

investment banking or securities business, including supervision, solicitation, conduct of business or training of persons associated with a member organization for any of these functions, shall be registered as principals. Such persons would include sole proprietors, officers, partners, managers of offices of supervisory jurisdiction, and directors of corporations.

Every member organization, except a sole proprietorship, would be required to have at least two officers or partners who are registered as principals with respect to each aspect of the member organization's investment banking and securities business;⁵ provided, however, that a proprietary trading firm with 25 or fewer registered representatives would only be required to have one officer or partner registered as a principal. The proposed rule would allow Phlx to waive the two-principal requirement in situations that indicate conclusively that only one person should be required to register as a principal.⁶

All persons who are to function as principals⁷ would be required to pass the General Securities Principal Qualification Examination (“Series 24”) and submit a Form U4 through WebCRD reflecting registration as such, unless a different category of principal registration applies. Each person seeking to register and qualify as a General Securities Principal would be required to, before or concurrent with such registration, become registered either as a General

⁵ See proposed Rule 604(g)(5)(A).

⁶ See proposed Rule 604(g)(5)(B).

⁷ Any person associated with a member organization as a registered representative whose duties are changed to require registration in any principal classification would be allowed a period of 90 calendar days following the change in his duties to pass the appropriate principal qualification examination. Upon elevation, the member organization shall submit to the Exchange through FINRA’s Central Registration Depository (“Web CRD”) an amended "Uniform Application for Securities Industry Registration or Transfer" (“Form U4”) and any applicable fees. No one may function as a principal beyond the initial 90 calendar day period following the change in his duties without having passed the appropriate qualification examination. See proposed Rule 604(g)(4).

Securities Representative or as a Limited Representative – Corporate Securities.⁸

The Exchange proposes to adopt a “Limited Principal – General Securities Sales Supervisor” category for persons whose supervisory responsibilities are limited.⁹ A person registered in this category solely on the basis of having passed the General Securities Sales Supervisor Qualification Examination (“Series 9/10”) would not be qualified to function in a principal capacity with responsibility over any area of business activity other than securities sales activity, nor be counted for purposes of fulfilling the requirement that member organizations have at least two principals.¹⁰

The Exchange also proposes to adopt a requirement that member organizations¹¹ register as a Limited Principal – Financial and Operations (“FINOP”), any associated person who performs enumerated financial and operational management duties (one of whom must be the Chief Financial Officer).¹² Each would be required to pass the Financial and Operations

⁸ The Limited Representative – Corporate Securities is a FINRA category of registration and requires passing the Series 62 examination. See FINRA Rule 1032(e).

⁹ Each person associated with a member organization who is included in the definition of principal in Phlx Rule 604(g) may register as a Limited Principal – General Securities Sales Supervisor if: (i) his supervisory responsibilities are limited to the securities sales activities of a member organization; (ii) he is registered pursuant to Exchange Rules as a General Securities Representative; and (iii) he is qualified to be so registered by passing an appropriate examination, which is the Series 9/10.

¹⁰ A Limited Principal – General Securities Sales Supervisor will not be qualified to perform for a member organization any of the following activities: (i) supervision of the origination and structuring of underwritings; (ii) supervision of market making commitments; (iii) final approval of advertisements as these are defined in Phlx Rule 605; (iv) supervision of the custody of firm or customer funds and/or securities for purposes of Rule 15c3-3 under the Act; or (v) supervision of overall compliance with financial responsibility rules for broker/dealers promulgated pursuant to the provisions of the Act.

¹¹ This applies to member organizations operating pursuant to Rule 15c3-1(a)(1)(ii), (a)(2)(i), or (a)(8) under the Act.

¹² These duties are: final approval and responsibility for the accuracy of financial reports

Principal Qualification Examination (“Series 27”).

Furthermore, in general, a person designated as a Chief Compliance Officer on Schedule A of Form BD of a member organization would be required to register with the Exchange as a General Securities Principal and pass the Series 24 examination (“Series 24”) before his registration could become effective, unless the person's activities are so limited to qualify him for one or more of the limited categories of principal registration.¹³

Phlx proposes to add that any person whose registration has been revoked by the Exchange as a disciplinary sanction, or whose most recent registration as Principal has been terminated for a period of two or more years immediately preceding the date of receipt by the Exchange of a new application, must pass a qualification examination for principals appropriate to the person’s category of registration.

Representative Registration – Rule 604(h) and Supplementary Material .04

Proposed Phlx Rule 604(h) and Supplementary Material .04 would govern the registration of representatives¹⁴ with the Exchange. All persons engaged or to be engaged in the

submitted to any duly established securities industry regulatory body; final preparation of such reports; supervision of individuals who assist in the preparation of such reports; supervision of and responsibility for individuals who are involved in the actual maintenance of the member organization's books and records from which such reports are derived; supervision and/or performance of the member organization's responsibilities under all financial responsibility rules promulgated pursuant to the provisions of the Act; overall supervision of and responsibility for the individuals who are involved in the administration and maintenance of the member organization's back office operations; or any other matter involving the financial and operational management of the member organization.

¹³ Pursuant to proposed Phlx Rule 604.01(c), a person registered solely as a General Securities Principal is not qualified to function as a FINOP or a Limited Principal – General Securities Sales Supervisor.

¹⁴ Phlx proposes to define “representative” as a member or an associated person of a registered broker or dealer, including assistant officers other than principals, who is engaged in the investment banking or securities business for the member organization including the functions of supervision, solicitation or conduct of business in securities or

investment banking or securities business of a member organization who are to function as representatives would be required to pass the Series 7, register as a General Securities Representative, and submit a Form U4 through WebCRD reflecting their registration status. Any person whose registration has been revoked by the Exchange as a disciplinary sanction or whose most recent registration as a representative or principal has been terminated for a period of two or more years immediately preceding the date of receipt by the Exchange of a new application would be required to pass the Series 7 examination. No member organization would be able to permit any member or person associated with it¹⁵ to engage in the investment banking or securities business¹⁶ unless the member organization determines that the person satisfies the qualification requirements and is not subject to statutory disqualification.¹⁷

Phlx Rule 604(i)(1)

The Exchange also proposes to adopt Phlx Rule 604(i)(1) exempting the following persons associated with a member organization from registration with the Exchange: (1) persons

who is engaged in training of persons associated with a broker or dealer for any of these functions. To the extent provided in Phlx Rule 604, all representatives are required to be registered with the Exchange and are referred to in Phlx's rulebook as "Registered Representatives." See proposed Phlx Rule 1(uu).

¹⁵ The term "associated person" or "person associated with" a member organization means any partner, officer, director, or branch manager of an Exchange member organization or applicant (or person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such member organization or applicant, or any employee of such member or applicant, except that any person associated with a member organization or applicant whose functions are solely clerical or ministerial shall not be included in the meaning of such term for purposes of the Exchange rules. See proposed Phlx Rule 1(vv). See also 15 U.S.C. 78c(a)(18).

¹⁶ The term "investment banking or securities business" means the business, carried on by a broker or dealer, of underwriting or distributing issues of securities, or of purchasing securities and offering the same for sale as a dealer, or of purchasing and selling securities upon the order and for the account of others. See proposed Phlx Rule 1(ww).

¹⁷ See Section 3(a)(39) of the Act; 15 U.S.C. 78c(a)(39).

whose functions are solely and exclusively clerical or ministerial; (2) persons who are not actively engaged in the investment banking or securities business; (3) persons whose functions are related solely and exclusively to the member organization's need for nominal corporate officers or for capital participation; and (4) persons whose functions are related solely and exclusively to: (A) effecting transactions on the floor of another national securities exchange and who are registered as floor members with such exchange; (B) transactions in municipal securities; (C) transactions in commodities; (D) transactions in security futures, provided that any such person is registered with FINRA or a registered futures association; (E) transactions in variable contracts and insurance premium funding programs and other contracts issued by an insurance company; (F) transactions in direct participation programs; (G) transactions in government securities; or (H) effecting sales as part of a primary offering of securities not involving a public offering pursuant to Section 3(b), 4(2), or 4(6) of the Securities Act of 1933 and the rules and regulations thereunder.

Phlx Rule 604(j)

Proposed Phlx Rule 604(j) provides that the Exchange may, in exceptional cases and where good cause is shown, waive an applicable qualification examination and accept other standards as evidence of an applicant's qualifications for registration.¹⁸

Other Changes

Pursuant to proposed Rule 604(i)(2), the Exchange proposes to allow a member organization, and persons associated with a member organization, to pay to non-registered foreign persons transaction-related compensation based upon the business of customers directed

¹⁸ Advanced age or physical infirmity will not alone constitute sufficient grounds to waive a qualification examination. Experience in fields ancillary to the investment banking or securities business may constitute sufficient grounds to waive a qualification examination.

to member organizations under certain enumerated conditions.¹⁹

III. Discussion and Commission Findings

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.²⁰ Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,²¹ 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, 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 believes that the proposed rule change is also consistent with Section 6(c)(3)(B) of the Act,²² which authorizes exchanges to prescribe standards of training, experience and competence for persons associated with exchange members, and gives exchanges the authority to bar a natural person from becoming a member or a person associated with a member, if the person does not meet the standards of training, experience and competence prescribed in the rules of the exchange. The Commission believes that the changes proposed by Phlx to its rules will strengthen the regulatory structure of the Exchange and should enhance the ability of member firms to comply with the Exchange's rules as well as with the federal securities laws.

¹⁹ Phlx also proposes to amend Rule 640, Commentary .01 to delete an outdated reference to "XLE," the Exchange's former trading system for NMS stocks, since XLE ceased operations in 2008.

²⁰ 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).

²¹ 15 U.S.C. 78f(b)(5).

²² 15 U.S.C. 78f(c)(3)(B).

Additionally, the Commission believes that the proposed rule change is consistent with the principles of Section 11A(a)(1)²³ of the Act in that it seeks to assure fair competition among brokers and dealers and among exchange markets. The Commission believes that the proposed rule will promote uniformity of regulation across markets, thus reducing opportunities for regulatory arbitrage. The proposed rule helps ensure that all persons conducting a securities business through Phlx are subject to registration, qualification and continuing education requirements, and are appropriately supervised, as the Commission expects of all self-regulatory organizations (“SROs”).

In order to meet its obligations under Section 6 of the Act²⁴ to enforce compliance by member firms²⁵ and their associated persons with the Act, the rules thereunder, and the exchange’s own rules, an exchange must have baseline registration and examination or qualification requirements for all persons conducting business on an exchange, as well as for those supervising such activity. In addition, SROs should have continuing education requirements for registered persons which help ensure that members and persons associated with their members are up to date on amendments to SRO rules and securities laws, rules, and regulations that govern their activities. Furthermore, an exchange must know if an associated person of a member firm is subject to a statutory disqualification.²⁶ This information is elicited

²³ 15 U.S.C. 78k-1(a)(1).

²⁴ Section 6 requires exchanges to have the ability to enforce compliance by their members and associated persons with the federal securities laws and with their own rules. 15 U.S.C. 78f.

²⁵ Broker and dealers are required to supervise the activities of their associated persons. See Section 15(b)(4)(E) of the Act.

²⁶ See Section 6(c)(2) of the Act and Rule 19h-1 under the Act. The Commission believes that it is important that certain registration information, such as whether an associated person is subject to a statutory disqualification, is available to exchanges and other regulators, including the Commission and the state securities regulators, through

by the Form U4, which is used by most exchanges and FINRA to register associated persons.

The Commission believes that Phlx's proposed rule change will help ensure that all associated persons of member organizations transacting business on PSX, as well as those who supervise, train or otherwise oversee those who do, will be registered with, and qualified by, the Exchange and will be subject to continuing education requirements. In addition, the proposal should strengthen the Exchange's ability to ensure an effective supervisory structure for those conducting business on PSX.²⁷ The requirements apply broadly and are intended to help close a regulatory gap which has resulted in varying registration, qualification, and supervision requirements across markets. Phlx will not allow any member organization to permit any person associated with it to engage in the investment banking or securities business through its facilities unless the member organization determines that such person satisfies the registration and qualification requirements and is not subject to statutory disqualification.

The Commission believes that Phlx's requirement that each person associated with a member organization who performs the functions of a representative, register with Phlx as a General Securities Representative and pass the Series 7 examination before registration may become effective, helps ensure that all associated persons who transact business on PSX, including those engaged in proprietary trading, are subject to appropriate registration, qualification, and continuing education requirements and is consistent with the Act. These requirements bolster the integrity of the Exchange by helping to ensure that all associated persons engaged in a securities business are, and will continue to be, properly trained and

WebCRD as well as members of the public through BrokerCheck, which derives information from WebCRD.

²⁷ Exchange Rule 748, Supervision, requires that all locations and activities of a member organization be supervised by a qualified supervisor. The principal registration requirement in proposed Rule 604(g) supplements Rule 748.

qualified to perform their functions and will be supervised and can be identified by regulators and the general public.

Similarly, the Commission believes that the requirement that all persons functioning in certain capacities be registered through WebCRD as principals and be subject to higher qualification standards appropriately identifies those persons with heightened accountability and reflects the enhanced responsibility of the principal role and is consistent with the Act. The general requirement that firms have a minimum of two principals responsible for oversight of member organization activity on Phlx - who must be registered as such and pass the Series 24 exam - should help Phlx strengthen the regulation of its member firms, and prepare those individuals for their responsibilities.

In addition, the Commission believes that requiring Chief Compliance Officers and any employee operating in the capacity of a FINOP to register with the Exchange as principals and take either the Series 24 or Series 27, respectively, is appropriate based on the heightened level of accountability inherent in the duty of overseeing compliance by an Exchange member, and in the oversight and preparation of financial reports and the oversight of those employed in the financial and operational capacities at each firm.

The Commission believes Phlx's proposed Limited Principal - General Securities Sales Supervisor category is appropriate as the qualification standards required reflect the narrower responsibility of persons in this category of registration.²⁸ Overall, the proposed new principal registration and qualification requirements should expand and strengthen the framework of supervisory rules that apply to Exchange member organizations and their associated persons

²⁸ A Limited Principal – General Securities Sales Supervisor may only supervise sales activities. Persons qualified only as Limited Principals – General Securities Sales Supervisors do not count toward the two-principal requirement of Rule 604(g)(5).

doing business on PSX.

The Commission believes Phlx's proposed provision requiring any person whose registration has been revoked by the Exchange as a disciplinary sanction or whose most recent registration as a principal or representative has been terminated for a period of two or more years immediately preceding the date of receipt by the Exchange of a new application, to pass the qualification examination appropriate to such person's category of registration is appropriate. This rule helps to ensure that persons' qualifications are current.

The Commission also believes Phlx's proposed exceptions from the above-discussed general requirements are appropriate. Any member seeking an exception from Phlx's mandate that each firm have two principals must provide evidence that conclusively indicates to the Exchange that only one principal is necessary. The Commission expects this authority to be used sparingly, since principals oversee the operations of member firms and provide the first line of defense in ensuring that member firms are complying with the rules of an exchange as well as the federal securities laws. In addition, the qualification examination waiver applies only in exceptional cases and requires the Exchange to have good cause;²⁹ the Commission believes this authority also should be used sparingly. The Commission expects the Exchange to maintain records and to utilize careful judgment in providing waivers. Finally, the Commission notes that these exceptions are substantively the same as exceptions provided to similar rules at other SROs.³⁰

²⁹ See proposed Rule 604(j).

³⁰ See, e.g., FINRA Rule 1070(d) and NASDAQ Rule 1070(d) regarding the examination waiver. See, e.g., FINRA Rule 1021(e)(2) and NASDAQ Rule 1021(e)(2) regarding the two-principal requirement waiver.

The Commission believes that proposed Rule 604(i)(2), which allows payment to finders when certain conditions are satisfied, is reasonable as it is consistent with the compensation arrangements allowed on other exchanges for foreign finders who direct business to member organizations.³¹

Finally, the Commission believes that adding paragraph (f) to Rule 604, specifying the applicability of paragraphs (g) and (h), and adding terms used in the proposed rules to its Definitions section will provide clarity to Phlx's rules, enabling regulators, members, and the general public to better understand the rules.

³¹ See NASDAQ Rule 1060(b) and NASDAQ OMX BX Rule 1060(b).

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,³² that the proposed rule change (SR-Phlx-2010-91), as modified by Amendment No. 1, be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³³

Florence E. Harmon
Deputy Secretary

³² 15 U.S.C. 78s(b)(2).

³³ 17 CFR 200.30-3(a)(12).