

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-82143; File No. SR-Phlx-2017-92)

November 22, 2017

Self-Regulatory Organizations; Nasdaq PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Adopt Investigatory and Disciplinary Processes Substantially Similar to Nasdaq BX, Inc. and The Nasdaq Stock Market LLC

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> notice is hereby given that on November 15, 2017, Nasdaq PHLX LLC (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by the Exchange. 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 adopt an investigatory and disciplinary process identical in all material respects to the investigatory and disciplinary processes of Nasdaq BX, Inc. (“BX”) and The Nasdaq Stock Market LLC (“Nasdaq”).

The text of the proposed rule change is available on the Exchange’s Website at <http://nasdaqphlx.cchwallstreet.com/>, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

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

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange 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

Phlx is proposing to adopt processes and related rules concerning investigative and disciplinary matters involving Phlx Members, Member Organizations, and persons associated with Member Organizations (also known as “Associated Persons”),<sup>3</sup> which are identical in all

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<sup>3</sup> Pursuant to Rule 1(n), a Member is a permit holder which has not been terminated in accordance with the By-Laws and these Rules of the Exchange. A Member is a natural person. Pursuant to Rule 1(o), the term “Member Organization” shall mean a corporation, partnership (general or limited), limited liability partnership, limited liability company, business trust or similar organization, transacting business as a broker or a dealer in securities and which has the status of a Member Organization by virtue of (i) admission to membership given to it by the Membership Department pursuant to the provisions of Rules 900.1 or 900.2 or the By-Laws or (ii) the transitional rules adopted by the Exchange pursuant to Section 6-4 of the By-Laws. Accordingly, a Member Organization is an entity and not a person (hence the name “organization”). Pursuant to Rule 908(c), a Member must be affiliated with a Member Organization. Every Member Organization must have at least one Member. A Member cannot be a broker or a dealer nor may a Member have associated persons. The Exchange notes that certain Exchange rules may lead a person to conclude that a Member may be a broker or a dealer and have persons associated with the Member. See, e.g., Rule 600(c). Notwithstanding any such ambiguities in the Phlx rules, a Member cannot be a broker or a dealer, and a Member cannot have persons associated with it on Phlx. In addition, Phlx does not currently have any Members that are a broker or a dealer, nor does it currently have any Members with associated persons. The Exchange will not allow a Member to be a broker or a dealer and have any associated persons in the future unless it amends its rules to allow for such Members and associated persons. Thus, the Exchange is replacing references to “members” in the BX rules with “member organizations” in the New Phlx rules, is replacing references to “persons associated with members” in BX rules with references to “persons associated with member organizations” in the New Phlx rules, and is clarifying any ambiguity in both the proposed New Phlx rules and certain existing Phlx rules that associated persons are associated with member organizations. As discussed above, the Exchange is amending the definition of “Member” to clarify that it is a natural person that is associated with a Member Organization. Accordingly, any references in the rules to an “associated person” or “persons associated with a member organization” also refer

material respects to the disciplinary process of Phlx's sister exchange BX, and substantially similar to that of Nasdaq.<sup>4</sup> The proposed change will provide uniform investigative and disciplinary processes applied to Members, Member Organizations, and persons associated with Member Organizations of Phlx and members and persons associated with members of BX, and Nasdaq, and harmonize the work FINRA conducts for these exchanges.

FINRA performs, among other things, investigatory and prosecutorial work for Phlx pursuant to a Regulatory Services Agreement between the two parties (the "RSA").<sup>5</sup> Under the RSA, FINRA is responsible for the investigation of potential violations of Phlx rules and the Exchange Act, and for the prosecution of any such violations thereof, by Phlx Members, Member Organizations, and Associated Persons. Moreover, under the RSA, Phlx's Regulation Department staff may elect to exercise jurisdiction over a matter involving a Phlx Member, Member Organization, or Associated Person, performing the investigation and any resulting prosecutorial work without FINRA's involvement. Upon the conclusion of FINRA's or staff's investigation of a matter involving a Member, Member Organization, or Associated Person, a

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to a Member. Thus, any instance where the terms "associated person" or "persons associated with a member organization" occur in the rules and the term "member" is omitted, the rule nonetheless applies to Members. The Exchange is separately reviewing its entire rulebook to determine where other such ambiguities exist and will file a rule change proposal to clarify any additional ambiguities in the rules.

<sup>4</sup> The BX disciplinary rules were based on those of Nasdaq with minor differences to the process discussed below. The Exchange is basing its new disciplinary rules on those of BX. Nevertheless, the majority of the new disciplinary rules proposed herein are materially identical to those of Nasdaq as well.

<sup>5</sup> See RSA (January 2013). The Exchange retains ultimate legal responsibility for the regulation of its Members, Member Organizations, and Associated Persons and its market. Both BX and Nasdaq have entered into RSAs with FINRA to perform the work under their respective Rule 8000 and 9000 Series. The Exchange will amend its RSA to include the new processes under New Rule 8000 and 9000 Series, and the related changes proposed herein, thus harmonizing the regulatory work FINRA conducts for all three self-regulatory organizations ("SROs").

proposed resolution is recommended to the Phlx Business Conduct Committee (“BCC”), which is charged with, among other things, the approval of action against a Member, Member Organization, or Associated Person. When a matter is contested, it may be reviewed by a Phlx Hearing Panel, which is charged with issuing a decision in such matters after reviewing evidence and considering arguments.

As discussed in detail below, Phlx is proposing to eliminate the BCC and the related hearings process, and adopt a new Exchange Review Council and a related adjudicatory process that mirrors that of the Exchange’s sister exchanges, BX, and Nasdaq. Under the new process, FINRA’s responsibilities will now include the adjudicatory roles currently performed by the BCC<sup>6</sup> and Hearings Panels<sup>7</sup> under the Rule 960 Series, and the Exchange Review Council will serve as the appellate body for cases appealed from new Hearing Panels. The Exchange Review Council will also serve as the appellate body for other determinations made by Phlx, such as reviewing appeals of determinations brought by market makers seeking review of a denial of reinstatement pursuant to Rule 3220, which are currently reviewed by the Exchange’s Market Operations Review Committee, as discussed below.<sup>8</sup> The Exchange Review Council will also be

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<sup>6</sup> As described below, case authorization and adjudicatory functions of the BCC and current Hearing Panels will be administered by FINRA’s Office of Disciplinary Affairs and Office of Hearing Officers, while other functions of the BCC will be handled by the Phlx Regulation Department, Department of Enforcement, and the Department of Market Regulation. In certain existing rules where the responsibilities under the rule do not fall within the Office of Disciplinary Affairs’ purview under the Codes of Procedure for FINRA, BX, Nasdaq or any other exchange, the Exchange is replacing the BCC with the Chief Regulatory Officer instead of the Office of Disciplinary Affairs.

<sup>7</sup> As described below, the current functions of the Phlx Hearings Panels will be handled by FINRA’s Hearing Panels.

<sup>8</sup> See New Rule 1(k). The Exchange Review Council will also review appeals brought under the New Rule 9280 (Contemptuous Conduct), New Rule 9520 Series (Eligibility Proceedings), New Rule 9550 Series (Expedited Proceedings), and New Rule 9600 Series (Procedure for Exemptions).

responsible for the approval of minor rule violation plan letters and violation letters under New Rule<sup>9</sup> 9216(b), and appeals of Membership Department determinations (for denials of membership pursuant to Rule 923) under the new process.

Decisions<sup>10</sup> issued by the Exchange Review Council may be reviewed by the Exchange Board of Directors (“Board”), which may also issue a decision in the matter.<sup>11</sup> Decisions issued by the Board are considered final action of the Exchange in a matter for purposes of appeals to the Commission.<sup>12</sup> Should the Board decline to review an Exchange Review Council decision, the decision is the final action of the Exchange.<sup>13</sup> Phlx notes that, because the new proposed process is derived from the BX and Nasdaq member investigative and adjudicatory processes, it will provide consistency in the procedure used to investigate and resolve matters concerning members of three of Nasdaq, Inc.’s U.S. exchanges.<sup>14</sup>

To implement the proposed change, Phlx is amending Phlx By-Law, Article V, Section 5-3, and its rules to adopt substantially similar text to that of BX and Nasdaq, reflect the changes to the process, and delete old text where necessary. Specifically and as discussed in greater detail below, the Exchange is deleting its current Disciplinary Rules found under the Rule 960 Series and replacing them with new investigatory and disciplinary rule sets under the New Rule 8000

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<sup>9</sup> Citation to rules of the proposed 8000 and 9000 Series herein will be preceded by “New Rule.”

<sup>10</sup> As defined by New Rule 9349. See also BX Rule 9349 and Nasdaq Rule 9349.

<sup>11</sup> See New Rule 9351(d) and (e).

<sup>12</sup> 15 U.S.C. 78s(d).

<sup>13</sup> See New Rule 9349(c).

<sup>14</sup> Nasdaq, Inc.’s other three exchanges, Nasdaq ISE, LLC, Nasdaq GEMX, LLC, and Nasdaq MRX, LLC, are in various stages of harmonizing their investigative and disciplinary processes with those of BX, Nasdaq, and FINRA.

and 9000 Series, which are in nearly all material respects identical<sup>15</sup> to the Rule 8000 and 9000 Series of BX, and substantially similar to the Rule 8000 and 9000 Series of Nasdaq.<sup>16</sup> Under the new process, the current BCC and Phlx Hearing Panels are generally being replaced with FINRA’s Office of Disciplinary Affairs (“ODA”)<sup>17</sup> and new Hearing Panels,<sup>18</sup> although in certain circumstances the BCC is being replaced by the Department of Enforcement,<sup>19</sup> the Department of Market Regulation,<sup>20</sup> Phlx Regulation Department<sup>21</sup> and/or the Chief Regulatory

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<sup>15</sup> The proposed New Rules are based on the BX rule set, which is substantially similar to the corresponding Nasdaq rule set. Significantly, the Nasdaq rules define Special Panelist, which is a category of Hearing Panelist BX does not have. A Special Panelist is an individual approved by the Nasdaq Board of Directors and selected by the Chief Hearing Officer to participate in proceedings in which certain issues arise, about which Nasdaq determined individuals with appropriate expertise and knowledge should be chosen. See Nasdaq Rule 9120(u). Like BX rules, the Exchange’s rules do not provide for such a category of Hearing Panelist and the Exchange does not believe that Special Panelists are needed at this juncture. Nasdaq also has a legacy category of Panelist who the Chief Hearing Officer may select, who is a person that served on FINRA’s National Adjudicatory Council (“NAC”), or on a disciplinary subcommittee thereof, prior to the date that Nasdaq commenced operation as a national securities exchange. See Nasdaq Rules 9231(b)(1)(D) and 9820(a)(4). Like BX, the Exchange is not adopting this category of person eligible to serve on a Panel.

<sup>16</sup> As discussed in greater detail below, unlike Nasdaq and BX, the Exchange operates a physical trading floor, which necessitates some changes to accommodate regulation of the floor.

<sup>17</sup> As defined under New Rule 9120(w).

<sup>18</sup> As defined under New Rule 9120(s).

<sup>19</sup> New Rule 9120(f)

<sup>20</sup> New Rule 9120(g).

<sup>21</sup> The Exchange is proposing to adopt a new defined term “Phlx Regulation Department” under New Rule 9120(v), which mirrors the definitions of “the Exchange’s Regulation Department” and “Nasdaq Regulation” under BX and Nasdaq Rules 9120(w), respectively, however, the proposed definition also expressly includes the Exchange’s Enforcement Department. Options Exchange Officials and Exchange staff acting in certain capacities are also considered staff of the Phlx Regulation Department. See note 47, *infra* for a description of the Phlx Regulation Department. The Exchange’s Enforcement Department is specifically charged with pursuing disciplinary action against Members, Member Organizations, Associated Persons and persons subject to the

Officer (“CRO”).<sup>22</sup> As a consequence, the Exchange is also eliminating references to the BCC and Phlx Hearings Panels in existing rules, deleting rules specifically relating to the BCC or Phlx Hearings Panels, and in certain cases replacing references to the BCC or Phlx Hearing Panels with the appropriate group or groups responsible for the process. The Exchange notes that, under the proposed New Rules, in certain instances the rules may reference an obligation or right of an Associated Person and not also include such a reference to a Member, notwithstanding that a Member is an Associated Person. In such cases, the obligation or right also applies to the Member unless otherwise expressly noted.

### **Current Phlx Rules and Adjudicatory Process**

Responsibility for the adjudication of Phlx rules is divided into two categories: (1) Rules for which the BCC and Hearing Panels are responsible for adjudicating as formal disciplinary proceedings; and (2) Rules under which fines may be assessed or privileges suspended in lieu of

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Exchange’s jurisdiction, and it is not affiliated with FINRA’s Department of Enforcement.

<sup>22</sup> The Exchange is replacing the BCC with the CRO instead of the ODA where the responsibilities under the rule do not fall within the ODA’s purview under the Codes of Procedure for FINRA, BX, Nasdaq or any other exchange. For example, Rule 777(a) prohibits a branch office manager of any member organization, an employee of any member organization engaged in trading in securities for the organization, and a securities salesman of any member organization, from guaranteeing the payment of the debit balance, in a customer’s account, to his employer or to any other creditor carrying such account, without the prior written consent of the BCC. The Exchange is proposing to replace the BCC with the CRO in this instance because this is not a normal function of the ODA and the CRO is in the best position to make such determinations. The Exchange is also replacing the BCC’s role in determining penalties under the Advices with the Department of Enforcement, the Department of Market Regulation, and Phlx Regulation Department, which will each individually have the authority to assess, and determine the amount of, fines under the Advices after repeated violations thereof, with the exception of the Advices relating to Order and Decorum for which the Phlx Regulation Department will be solely responsible for assessing and determining the amount of fines thereunder.

disciplinary action.<sup>23</sup> Specifically, in lieu of conducting a formal disciplinary proceeding, Rules 60 (Sanctions for Breach of Regulations) and 970 (Floor Procedure Advices: Violations, Penalties, and Procedures) provide alternative disposition of violations through assessment of a fine and/or suspension of trading floor privileges.<sup>24</sup> Rules 60 and 970 provide the process for administering fines for violations of the Options Floor Procedure Advices and Equity Floor Procedure Advices<sup>25</sup> (collectively, the “Advices”), which include regulations that comprise the Exchange’s minor rule violation plan (“MRVP”) as well as violations of Order and Decorum Regulations that are not included in the Exchange’s MRVP but may be considered minor in nature and thus possibly resolved outside of the formal disciplinary process.<sup>26</sup>

Generally, notice to the SEC of final disciplinary action by an SRO is required pursuant to Rule 19d-1 of the Exchange Act; however, uncontested fines of \$1,000 or less or exclusion of a clerical employee from the trading floor for five days or less for violations of regulations that relate to administration of order, decorum, health, safety, and welfare (“Order and Decorum”)

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<sup>23</sup> Fines may be assessed by an Options Exchange Official or by Exchange staff. In certain circumstances, an Options Exchange Official and an officer of the Exchange, as defined by Rule 60(c)(ii), may exclude a Member from the trading floor.

<sup>24</sup> None of the fines assessed in lieu of formal disciplinary action exceed [sic] \$10,000. Under both Rules 60 and 970, matters may alternatively be referred for formal disciplinary proceedings.

<sup>25</sup> The Exchange notes that it no longer operates an equity trading floor. The regulations under the Equity Trading Floor Advices relate to requirements such as notices, record retention, and compliance with Exchange inquiries.

<sup>26</sup> For example, Options Floor Procedure Advice F-35 concerns violations of exercise and exercise advice rules for noncash-settled equity option contracts imposes a fine of \$1,000 for the first violation of the Advice, a fine of \$2,500 for the second violation of the Advice, and \$5,000 for the third and each subsequent violation of the Advice. The first two fines would fall under the Exchange’s MRVP as they are \$2,500 or less in amount, whereas the third and subsequent violations would not as they are in excess of \$2,500, but may be considered as “minor” and not subject to formal disciplinary action. As is currently the case, the Exchange may choose to pursue formal disciplinary action in lieu of resolving a violation of the Advices through fine and/or suspension.



are not required to be reported to the SEC. In addition, uncontested fines of \$2,500 or less assessed for violation of MRVP rules are subject to abbreviated periodic SEC reporting.

Rule 60 provides the process for regulating Order and Decorum on the Exchange's trading floor. The Order and Decorum rules are found under Section H of the Options Floor Procedure Advices. Pursuant to Rule 60, both Exchange staff and Options Exchange Officials<sup>27</sup> have authority to fine a Member, Member Organization, or Associated Person for violations of any of the Order and Decorum regulations under the Options Floor Procedure Advices in lieu of conducting a formal disciplinary proceeding.

In addition, an Options Exchange Official and an officer of the Exchange may exclude a Member or Associated Person from the trading floor. Both Exchange staff and Options Exchange Officials may alternatively refer the matter to the BCC for formal disciplinary proceeding, which would be charged with determining whether a fine or formal disciplinary proceeding is appropriate.

Under Rule 60, a Member, Member Organization, or Associated Person may contest a fine by requesting a hearing before a Hearing Director appointed by the Chair of the BCC, who may overturn, affirm, or modify the citation. The Hearing Director's determination is final. A

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<sup>27</sup> The President of the Exchange and his designated staff shall have general supervision over: (i) the options trading floor as well as general supervision of the dealings of members on the trading floor and on Exchange trading systems and of the premises of the Exchange immediately adjacent thereto; (ii) the activities of specialists, registered option traders, floor brokers, or other types of market makers and shall establish standards and procedures for the training and qualification of members active on the trading floor; (iii) all trading floor employees of members, and shall make and enforce such rules with respect to such employees as it may deem necessary; (iv) all connections or means of communications with the options trading floor and may require the discontinuance of any such connection or means of communication when, in the opinion of the President or his designee, it is contrary to the welfare or interest of the Exchange; (v) the location of equipment and the assignment and use of space on the options trading floor; and (vi) relations with other options exchanges. See Rule 1000(e).

determination to exclude a Member, Member Organization, or Associated Person from the trading floor is not appealable.

Rule 970 provides the process for regulating other behavior pursuant to the Advices not related to Order and Decorum through assessment of a fine.<sup>28</sup> Fines assessed under the Advices increase with each subsequent violation and after a set number of repeated violations, are thereafter are [sic] assessed at the discretion of the BCC, which may, as an alternative to assessing a fine, recommend the matter for formal disciplinary proceeding. Notwithstanding, determinations to issue a fine are made on a case by case basis, whereby the Exchange considers the individual facts and circumstances to determine whether a fine of more or less than the recommended amount is appropriate for the violation, or whether the violation requires formal disciplinary action. Fines of \$2,500 or less levied for violations of the Advices, other than Order and Decorum, are included in the Exchange's MRVP, whereas any fine exceeding \$2,500 under the Advices is not. If a Member, Member Organization, or Associated Person contests a fine, it must provide a written response meeting the requirements of an "Answer," as set forth in Rule 960.4, which is thereafter provided to the BCC for its consideration.

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<sup>28</sup> Under the Advices, the Exchange assesses fines ranging from \$50 to \$10,000. Pursuant to paragraph (c) of Rule 19d-1 of the Exchange Act, the Commission allows SROs to submit for Commission approval plans for the abbreviated reporting of minor disciplinary infractions (i.e., an MRVP). Any disciplinary action taken by an SRO against any person for violation of a rule of the SRO which has been designated as a minor rule violation pursuant to such an MRVP filed with, and declared effective by, the Commission shall not be considered "final" for purposes of Rule 19d-1(c)(1) of the Exchange Act if the sanction imposed consists of a fine not exceeding \$2,500 and the sanctioned person has not sought an adjudication, including a hearing, or otherwise exhausted his administrative remedies under Section 19d-1(c)(2). Most fines assessed under both Advices that do not exceed \$2,500 are included in the MRVP pursuant to Exchange Act Rule 19d-1(c)(2). Order and Decorum Regulations under the Option Floor Procedure Advices, however, are not included in the MRVP, but may be subject to an exemption from the notice requirement of Exchange Act Rule 19d-1(c)(1) if the fine does not exceed \$1,000.

With respect to violations that are adjudicated by the BCC and Hearing Panels, Rule 960.2(f)(i) requires the BCC to direct Exchange staff to initiate a Statement of Charges when it appears that there is probable cause for finding that a violation within the jurisdiction of the Exchange has occurred and disciplinary action is warranted.

The BCC is a Board-appointed committee<sup>29</sup> with jurisdiction to monitor compliance with the Act and the rules and regulations thereunder, the By-Laws and rules of the Exchange or any interpretation thereof, and the rules, regulations, resolutions, and stated policies of the Board or any Exchange committee, by Members, Member Organizations, and Associated Persons.<sup>30</sup> The BCC reviews disciplinary matters involving Members, Member Organizations, and Associated Persons, which are first identified generally by Phlx's Market Surveillance group and referred to FINRA to investigate and to propose a recommended resolution pursuant to the RSA.<sup>31</sup>

Under the RSA, FINRA is responsible for, among other things, the investigation of matters referred from the Phlx Market Surveillance and Membership departments, and the performance of routine and cause examinations of Phlx Members, Member Organizations, and Associated Persons. FINRA is also responsible for providing services related to Phlx's formal disciplinary process, including issuance of Wells Notices, Cautionary Action Letters, Statements of Charges, settlements, disciplinary decisions, and prosecution.

Upon completion of an investigation, FINRA analyzes the evidence and applicable law, and makes a preliminary determination of whether or not a violation appears to have occurred.

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<sup>29</sup> The BCC meets quarterly and on an as-needed basis.

<sup>30</sup> See Phlx By-Law, Article V, Sec. 5-3(b).

<sup>31</sup> The Phlx Market Surveillance group is responsible for detecting potentially violative conduct among Members, Member Organizations, and Associated Persons and referring such conduct to FINRA for investigation pursuant to the RSA. In a small number of cases, Phlx enforcement staff will investigate potentially violative conduct and recommend a resolution to the BCC.

Known as a “Sufficiency of Evidence” review, it is the same process followed by FINRA staff in matters involving Members, Members Organizations and Associated Persons for the Exchange; however, in such matters the BCC provides authorization to proceed as proposed by FINRA instead of the ODA, as described below.<sup>32</sup> The Sufficiency of Evidence review determines whether FINRA will recommend that the Exchange negotiate a settlement, issue a Cautionary Action Letter, or pursue formal action against a Member, Member Organization, or Associated Person.<sup>33</sup> FINRA presents its recommendations to the BCC for approval at both periodic and ad hoc meetings. In order to become an official action of the Exchange, FINRA must gain BCC approval of its recommendation.<sup>34</sup> The BCC may approve, deny or modify each recommendation presented to it. In cases that FINRA recommends issuance of a Statement of Charges,<sup>35</sup> it prepares a memorandum and draft Statement of Charges for review and approval by the BCC. In certain cases, FINRA will also negotiate a settlement with a Respondent in addition to recommending the issuance of a Statement of Charges. In such cases, FINRA will provide the BCC with an offer of settlement together with a draft Statement of Charges for the BCC’s review and approval.<sup>36</sup> If a recommendation to issue a Statement of Charges is approved, FINRA will

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<sup>32</sup> See FINRA Regulatory Notice 09-17 (March 2009) at 3 ([available at http://www.finra.org/sites/default/files/NoticeDocument/p118171.pdf](http://www.finra.org/sites/default/files/NoticeDocument/p118171.pdf)).

<sup>33</sup> Id.

<sup>34</sup> Rule 960.2.

<sup>35</sup> Rule 960.3.

<sup>36</sup> The offer of settlement is negotiated with, and signed by, the Respondent prior to FINRA’s presentation of the proposed Statement of Charges to the BCC. Providing a draft Statement of Charges together with the proposed offer of settlement to the BCC at the same meeting facilitates expeditious resolution in cases where both parties have come to an agreement on how to settle the matter. The process also allows the BCC to consider the facts and circumstances of the matter at the time it is presented to it for approval, including that the Respondent has committed to settle the matter based on the Statement of Charges recommended by FINRA. If the BCC approves the issuance of the Statement of Charges in these matters it also accepts the offer of settlement, and considers it the

finalize the approved Statement of Charges based on the BCC's recommendation, which is signed by the BCC's chairperson and then served on the Member, Member Organization, and/or Associated Person.<sup>37</sup>

In certain cases, a Member, Member Organization, or Associated Person will not accept the allegations made against it in the Statement of Charges. If a Member, Member Organization, or Associated Person does not agree with the allegations, it may request that a Hearing Panel review the matter pursuant to Rule 960.5(a)1. Hearing Panels are charged with reviewing the facts and circumstances of a contested matter, and determining whether the Member, Member Organization, or Associated Person has committed a violation and if so, what the appropriate sanctions are, if any. A Hearing Panel also issues a written decision in conformity with its determination.<sup>38</sup> Moreover, a Hearing Panel may hold summary disposition hearings and issue a summary decision in cases where any Member, Member Organization, or Associated Person has admitted to a violation, or if there is no dispute concerning those material facts which give rise to such a violation.<sup>39</sup> Pursuant to Rule 960.9, a Hearing Panel decision may be appealed to the Board.

The BCC may also examine the business conduct and financial condition of a Member, Member Organization or Associated Person, and may authorize the initiation of any disciplinary

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Respondent's Answer. Like other matters involving an offer of settlement, where the BCC accepts an offer of settlement it must issue a decision and impose sanctions consistent with the terms of such offer. See Rule 960.7. Thus, after issuance of the Statement of Charges and acceptance of the offer of settlement, FINRA provides the BCC Chair, or its designee, with a draft Decision informing the Respondent that the BCC has accepted the offer of settlement.

<sup>37</sup> Rule 960.3.

<sup>38</sup> Rule 960.5(a)(3).

<sup>39</sup> Rule 960.6.

actions or proceedings brought by the Exchange.<sup>40</sup> With respect to disciplinary actions, the BCC or its designee (including a Hearing Panel) shall impose appropriate sanctions of expulsion, suspension, fine, censure or any other fitting sanction where the BCC or its designee finds that a violation within the disciplinary jurisdiction of the Exchange has been committed.<sup>41</sup> The BCC may also direct a general partner(s) or an executive officer(s) of a Member Organization to appear before the BCC or its designee for examination upon forty-eight hours' notice, either oral or in writing and, after such examination, the BCC has authority to suspend such Member Organization until the requirements of the financial responsibility and reporting rule<sup>42</sup> are fully met.

The BCC may also prescribe regulations for the carrying of securities on margin by Members and Member Organizations for customers, and it may also make such regulations in regard to the segregation or hypothecation of securities carried in customers' accounts as it deems advisable.<sup>43</sup> The BCC may prohibit trading by a Member or Member Organization that is excessive in view of such person's or organization's capital.<sup>44</sup> The BCC may require or request detailed financial reports or such other operational reports as it deems necessary,<sup>45</sup> and supervise the advertising of Members and Member Organizations.<sup>46</sup>

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<sup>40</sup> Phlx By-Law, Article V, Sec. 5-3(b).

<sup>41</sup> Id.

<sup>42</sup> See Phlx By-Law, Article V, Sec. 5-3(b)(c); see also Rule 703.

<sup>43</sup> Phlx By-Law, Article V, Sec. 5-3(b)(d). Such proscriptive power is subject to the SEC rulemaking process.

<sup>44</sup> Phlx By-Law, Article V, Sec. 5-3(b)(e).

<sup>45</sup> Phlx By-Law, Article V, Sec. 5-3(b)(f).

<sup>46</sup> Phlx By-Law, Article V, Sec. 5-3(b)(g).

## The New Process and FINRA's Role

### Resolution by Fine or Acceptance, Waiver, and Consent

Under the proposed new process, the Exchange will continue to have authority to resolve certain violations outside of the formal disciplinary process. Options Exchange Officials and Exchange staff will continue to have authority to investigate possible violations of the Advises, issue fines, and in certain cases suspend trading floor access for violations of the Advises. The authority to resolve violations outside of the formal disciplinary process exists under proposed New Rule 9216. New Rule 9216 provides alternatives to the issuance of a formal complaint and the initiation of a formal disciplinary proceeding, which include the assessment of fines or exclusion from the Exchange's options trading floor. The Exchange is proposing to adopt New Rule 9216(a) (Acceptance, Waiver, and Consent Procedures). It will provide a new process by which the Phlx Regulation Department, the Department of Enforcement or the Department of Market Regulation<sup>47</sup> – if they have reason to believe a violation has occurred and the Member, Member Organization or Associated Person does not dispute the violation – may prepare and

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<sup>47</sup> Phlx is adopting new defined terms “Department of Enforcement” the “Department of Market Regulation” under New Rules 9120(f) and (g), respectively, which are also defined in BX and Nasdaq under their respective Rules 9120. These two departments are authorized to act on behalf of BX and Nasdaq in investigating and administering disciplinary matters pursuant to [sic] regulatory service [sic] agreement, and will do the same for Phlx upon adoption of the new process. Phlx is also adopting a new defined term “Phlx Regulation Department,” which is the department of Phlx that administers the Code, and includes the Phlx Enforcement Department. See New Rule 9120(v); see also note 21, supra. As described above, Options Exchange Officials, and Exchange staff acting in certain capacities are also considered staff of the Phlx Regulation Department. Phlx notes that the Phlx Regulation Department currently exists and is responsible for, among other things, preparing matters for review by the BCC. Under the new process, the Phlx Regulation Department will have the option of investigating and bringing matters to the ODA directly for review and possible authorization of a disciplinary action, or alternatively may provide a matter to the Department of Enforcement or Department of Market Regulation to investigate and present to the ODA for possible authorization of a disciplinary action.

request that the Member, Member Organization or Associated Person execute a letter accepting a finding of violation, consenting to the imposition of sanctions, and agreeing to waive such Member's, Member Organization's or Associated Person's right to a hearing before a Hearing Panel or, if applicable, an Extended Hearing Panel, and any right of appeal to the Exchange Review Council, the Commission, and the courts, or to otherwise challenge the validity of the letter, if the letter is accepted. If the acceptance, waiver and consent is accepted, the matter is resolved without issuance of a complaint. The Exchange does not currently have an analogous process. However, the Exchange believes that providing its Members, Member Organizations and Associated Persons the optionality to dispose of a matter prior to the issuance of a complaint will make the process fairer for its participants. In certain respects, the process is similar to the Exchange's current offer of settlement process, discussed above, by which FINRA recommends acceptance of an offer of settlement and provides a draft Statement of Charges to the BCC for its review and approval, together with an executed offer of settlement. This process results from negotiation with the Member, Member Organization or Associated Person prior to the approval of the offer of settlement, like an acceptance, waiver, and consent. An important difference is that, unlike the current offer of settlement process, which requires the issuance of a Statement of Charges and decision, an acceptance, waiver and consent under New Rule 9216(a) is proposed in lieu of a complaint.<sup>48</sup> Thus, under the new rule, if the Phlx Regulation Department, the Department of Enforcement or the Department of Market Regulation has reason to believe a violation has occurred and the Member, Member Organization, or Associated Person does not

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<sup>48</sup> The Exchange is also adopting New Rule 9270, which provides the settlement process once a complaint has been issued in a matter. Thus, the process under New Rule 9216(a) occurs in lieu of the issuance of a complaint, whereas the process under New Rule 9270 is applicable to Respondents that have been provided notice that a proceeding has been instituted against him or her [sic]. New Rule 9270 will replace the settlement process provided under Rule 960.7, as discussed below.



dispute the violation, then the Phlx Regulation Department, the Department of Enforcement or the Department of Market Regulation may prepare and request that the Member, Member Organization, or Associated Person execute a letter accepting the violation, consenting to the imposition of sanctions, and agreeing to waive any right of appeal, if the letter is accepted.<sup>49</sup> The letter must be approved by the Review Subcommittee,<sup>50</sup> FINRA's ODA,<sup>51</sup> or the Exchange Review Council to become a final action of the Exchange.<sup>52</sup> The process under New Rule 9216(a) is the same process used by BX and Nasdaq under their respective Rules 9216(a).

The Exchange is also adopting New Rule 9216(b) to address the process for administering violations of regulations that are resolved by assessment of a fine, including regulations subject to the Exchange's minor rule violation regulations,<sup>53</sup> other than Order and Decorum, in lieu of the current process under Rule 970.<sup>54</sup> The Exchange is adopting procedures applicable to violations of the Advices subject to the MRVP under New Rule 9216(b)(1), and is adopting procedures applicable to other violations of the Advices not included in the MRVP under New Rule 9216(b)(2). The Exchange notes that neither BX nor Nasdaq have [sic] regulations analogous to the Advices with fines up to \$10,000. Therefore, BX and Nasdaq do

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<sup>49</sup> New Rule 9216(a)(1).

<sup>50</sup> As defined in New Rule 9120(bb).

<sup>51</sup> The Office of Disciplinary Affairs is a FINRA group independent of the enforcement function. See discussion infra, p. 25 [sic].

<sup>52</sup> New Rule 9216(a)(3) and (4).

<sup>53</sup> The Exchange's minor rule violation regulations include both fines included in its MRVP and other fines up to \$10,000.

<sup>54</sup> As discussed below, the Exchange is adopting New Rules 9216(b)(1)(E) and 9216(b)(2)(E) to account for the process provided under Rule 970 concerning imposing fines under the Option Floor Procedure Advices, when the number of violations under Exchange Rules is determined based upon an exception-based surveillance program. BX and Nasdaq Rules 9216(b) do not have a similar rule, allowing "batching" of violations under certain conditions. Thus, the Exchange is keeping the process provided by Rule 970, Commentary .01.

not need to adopt separate rules addressing how violations resolved through a fine in lieu of formal disciplinary proceedings in excess of \$2,500 are managed. Thus, both BX and Nasdaq Rules 9216(b) solely address the procedures for violations of rules subject to their respective MRVPs pursuant to Rule 19d-1(c)(2) of the Exchange Act.

The Exchange is proposing to adopt New Rule 9216(b)(1) to address the process for administering fines included in the Advices that do not exceed \$2,500 and are included in the MRVP. Unlike Rule 970, which provides a process whereby the Exchange issues a citation that may be subsequently contested by the Member, Member Organization, or Associated Person, New Rule 9216(b) does not provide a similar process. Under New Rule 9216(b)(1) and like the comparable rules of BX and Nasdaq, the Department of Enforcement or Department of Market Regulation may prepare and provide an MRVP letter to a Member, Member Organization, or Associated Person for its signature. Unlike the BX and Nasdaq rules, the Exchange is also vesting the Phlx Regulation Department with the same authority given to the Department of Enforcement and Department of Market Regulation to administer the MRVP letter process.<sup>55</sup> The Exchange notes that a Member, Member Organization, or Associated Person is not obligated to agree to the terms of an MRVP fine or submit an MRVP letter for approval. The Exchange will issue an MRVP letter for execution by the Member, Member Organization, or Associated Person,<sup>56</sup> and the executed letter must thereafter be approved by the Exchange Review Council,

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<sup>55</sup> The Phlx Regulation Department would prepare MRVP letters (and violation letters as discussed below) when it is the body that investigated the violation. This would occur commonly with violations of floor-based Advices. Options Exchange Officials are considered members of the Phlx Regulation Department, as are Exchange Staff when acting pursuant to the Advices; thus, Options Exchange Official and Exchange Staff rulings are considered action of the Phlx Regulation Department.

<sup>56</sup> New Rule 9216(b)(1)(A).

Review Subcommittee or the ODA.<sup>57</sup> If the terms are not accepted, then the Exchange or FINRA on behalf of the Exchange may pursue formal disciplinary proceedings.<sup>58</sup> As a consequence, under the New Rules there is no ability for a fine to be reversed, modified or affirmed, prior to formal disciplinary proceedings. The Exchange notes that this is consistent with the processes used by BX, Nasdaq, and FINRA.

The Exchange will follow the same process for violations of the Advices not included in the MRVP.<sup>59</sup> Specifically, the Exchange is proposing to adopt New Rule 9216(b)(2) to address the Exchange's authority to issue fines for violation of the Advices, other than violation of the Order and Decorum regulations, that exceed \$2,500 (and are thus not included in the MRVP), but are not greater than \$10,000. As discussed above, under Rule 970 the Exchange has authority to assess a fine up to \$10,000 under the Advices in lieu of pursuing formal disciplinary proceedings. The Exchange is proposing to provide the same procedures as applied to fines assessed for violations of regulations subject to the MRVP. However, violations of the Advices that result in a fine greater than \$2,500 up to the maximum fine assessed under the Advices of

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<sup>57</sup> New Rule 9216(b)(1)(C). The Exchange notes that, as is the case with BX and Nasdaq Rules 9216(b), a letter issued under New Rule 9216(b) is considered an action of the Review Council; however, the Review Subcommittee of the Review Council or ODA may accept such a letter on behalf of the Review Council by delegated authority. See New Rules 9216(b)(1)(A) and (C), and New Rules 9216(b)(2)(A) and (C).

<sup>58</sup> New Rule 9216(b)(1)(D).

<sup>59</sup> Instead of issuing an MRVP letter, letters issued by the Exchange under New Rule 9216(b)(2) are termed "violation letters." As a consequence of the two types of minor rule violation letters, the Exchange is adopting New Rule 9143(e)(3) and New Rule 9144(c)(3), which discuss certain waivers in relation to ex parte communications and separation of functions, to include violation letters in addition to MRVP letters. As a consequence, these two new rules differ from the analogous rules of BX and Nasdaq, neither of which have [sic] violation letters.

\$10,000 are not eligible for an exception to the reporting requirements of Rule 19d-1(c)(1) of the Act.<sup>60</sup>

Last, the Exchange is proposing to adopt New Rule 9216(c) to address the process followed for violations of the Order and Decorum regulations under the Advices, none of which are [sic] included in the MRVP. The fines assessed for violations of the Order and Decorum Advices range from \$50 to \$10,000. Thus, fines assessed for violation of Order and Decorum regulations of \$1,000 or less may be exempt from the reporting requirements of Rule 19d-1(c)(1) of the Exchange Act.<sup>61</sup> The Exchange notes that, because BX and Nasdaq do not have trading floors, their respective Rules 9216 do not address violations of Order and Decorum. Accordingly, the Exchange is incorporating the provisions of current Rule 60 into proposed New Rule 9216(c), largely unchanged. The Exchange is retaining sole jurisdiction to review violations of Order and Decorum under New Rule 9216(c) because the regulations arise from the operation of the trading floor. Nevertheless, non-compliance with the Order and Decorum regulations may result in referral for formal disciplinary action, which would then proceed pursuant to the New Rule 9000 Series.<sup>62</sup>

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<sup>60</sup> See 17 CFR 240.19d-1(c)(1); supra note 28.

<sup>61</sup> Id.

<sup>62</sup> In cases where the Phlx Regulation Department determines that formal disciplinary action is appropriate for a violation of Order and Decorum, it would provide the recommendation to the ODA directly, or may provide it to the Department of Enforcement or Department of Market Regulation to manage the ODA review process. See, e.g., New Rule 9216(c). The Exchange notes that Phlx Regulation Department may provide the recommendation to the ODA directly, or may provide it to the Department of Enforcement or Department of Market Regulation to manage the ODA review process for each of the processes under New Rule 9216(a), (b) and (c). As discussed above, both Options Exchange Officials and Exchange Staff are considered members of the Phlx Regulation Department. Supra note 55.

## Disciplinary Process

With respect to the formal disciplinary process, Phlx is retiring the BCC and its related processes and adopting new policy and disciplinary processes that are derived from those of BX and Nasdaq. Phlx and FINRA amended the RSA to include the processes formerly conducted by the BCC and Hearing Panels. As such, FINRA will now not only investigate possible violation of Phlx rules and federal securities laws and recommend action against Members, Member Organizations, and Associated Persons, but FINRA will also adjudicate matters pursuant to the Exchange's new rules.<sup>63</sup> In this regard, the case authorization and adjudicatory functions of the BCC and current Hearing Panels will be administered by FINRA's ODA and Office of Hearing Officers ("OHO"), respectively.

The ODA is an office within FINRA, independent of the FINRA enforcement function and not involved in investigating or litigating cases.<sup>64</sup> Similar to the BCC, the ODA reviews each proposed complaint to determine the legal and evidentiary sufficiency of proposed charges and settlements.<sup>65</sup> Like matters presented to the BCC for its determination of whether to initiate

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<sup>63</sup> In certain instances, as set forth in proposed New Rule 9211(a)(1), Phlx Regulation will retain discretion to investigate potentially violative conduct itself and recommend a resolution to FINRA. In this respect, New Rule 9211(a)(1) will differ from the corresponding provisions of the BX and Nasdaq Rules.

<sup>64</sup> Supra note 32 at 4.

<sup>65</sup> Id. The ODA also reviews and accepts uncontested offers of settlement for FINRA matters (FINRA Rule 9270(e)(2)), and for BX and Nasdaq matters pursuant to their respective Rules 9270(e)(2). The ODA also has sole authority to accept or reject uncontested offers of settlement involving affiliates of BX and Nasdaq pursuant to their respective Rules 9270(e). As a practical matter, FINRA has informed the Exchange that the ODA reviews nearly all uncontested offers of settlement for possible acceptance, however, the ODAs authority to reject uncontested offers of settlement is limited to those involving affiliates of the Exchange. Accordingly, the Exchange is proposing to make it clear in New Rule 9270(e) and subparagraph (2) thereunder that the ODA may accept an offer of settlement and order of acceptance or refer them to the Exchange Review Council, and it may also reject uncontested offers of settlement in matters involving an affiliate of the Exchange pursuant to New Rule 9270(e).

charges,<sup>66</sup> a recommendation proposed by FINRA staff or the Phlx Regulation Department as proposed herein in a matter involving formal disciplinary action cannot proceed without approval by the ODA.<sup>67</sup> If a complaint is authorized by the ODA, then FINRA’s Department of Enforcement or the Department of Market Regulation or the Phlx Regulation Department as proposed herein<sup>68</sup> must issue the complaint, which is filed with the OHO.<sup>69</sup>

The OHO, like the ODA, is an independent office within FINRA not involved in investigating or litigating cases. The OHO is responsible for the administration of the hearing process. Under the new process, hearings will be held before a Hearing Officer and two

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<sup>66</sup> See Rule 960.2(f).

<sup>67</sup> Supra note 32 at 4; see also New Rule 9211(a).

<sup>68</sup> In addition to retaining discretion to investigate potentially violative conduct and recommending a resolution to FINRA, the Phlx Regulation Department is also retaining discretion to prosecute matters as a party before Hearing Panels. As a consequence, the Exchange has included reference to the Phlx Regulation Department in the New Rule 9200, 9300 and 9800 Series whereas the analogous rules of BX and Nasdaq do not include references to their respective Regulation Departments. Likewise, the Exchange is proposing to include the Phlx Regulation Department in the definition of “Party” under proposed New Rule 9120(z) for purposes of the New Rule 9200, 9300 and 9800 Series. The Exchange is also including the New Rule 9400 Series as covered by the term “Party.” Although, omitted from the related definitions of “Party” under the BX, Nasdaq and FINRA rules, the Exchange believes that it is appropriate to include the New Rule 9400 Series because it concerns expedited client suspensions whereby the Phlx Regulation Department, Department of Enforcement, or the Department of Market Regulation at the direction of the CRO or another senior officer, may initiate expedited suspension proceedings with respect to alleged violations of Rule 774. The New Rule 9400 Series includes a hearings process in which the Phlx Regulation Department, Department of Enforcement, or the Department of Market Regulation and the Member, Member Organization or Associated Person subject to expedited suspension are considered Parties to the matter. The Exchange notes that, although the BX and Nasdaq rules do not include the Department of Enforcement or the Department of Market Regulation, nor do they mention FINRA, it believes that including FINRA and its departments in proposed New Rule 9400 Series is appropriate because they may be involved in the initiation of such a matter for BX and Nasdaq currently. Thus, the proposed addition is a clarifying change. As such, the Exchange believes that including the New Rule 9400 Series under the definition “Party” is appropriate.

<sup>69</sup> See New Rule 9212(a)(1).

Panelists, with limited exception.<sup>70</sup> Panelists are selected by the Chief Hearing Officer and must be a person who: (i) previously served on the Exchange Review Council; (ii) previously served on a disciplinary subcommittee of the Exchange Review Council, including a Subcommittee, an Extended Proceeding Committee, or their predecessor subcommittees; (iii) previously served as a Director, or as a Governor of the Exchange prior to its acquisition by Nasdaq, Inc., but does not serve currently in that position; or (iv) is a FINRA Panelist approved by the Board at least annually, including a member of FINRA’s Market Regulation Committee or who previously served on the Market Regulation Committee not earlier than four years before the date the complaint was served upon the Respondent who was the first served Respondent in the disciplinary proceeding for which the Hearing Panel or the Extended Hearing Panel is being appointed, or from other sources the Board deems appropriate given the responsibilities of Panelists.<sup>71</sup>

Upon the filing of a complaint, the respondent is afforded time to reply and request a hearing.<sup>72</sup> The hearing process begins at this juncture, unless the respondent waives a hearing,<sup>73</sup> and the Hearing Officer, Hearing Panel or, if applicable, the Extended Hearing Panel,<sup>74</sup> does not

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<sup>70</sup> New Rule 9231(b). As noted in the New Rule, there are certain limited circumstances whereby a hearing may proceed without the participation of a Hearing Officer or two Panelists, such as when Hearing Officer becomes incapacitated, or otherwise is unable to continue service after being appointed, and the replacement Hearing Officer determines to allow the Panelist to resolve the matter without his or her participation. See New Rule 9231(e)(1). See also New Rule 9234(a), (c), (d), and (e).

<sup>71</sup> New Rule 9231(b).

<sup>72</sup> See New Rules 9215 and 9221.

<sup>73</sup> Under New Rule 9221(a), a respondent may waive its right to a hearing if it fails to request a hearing in its answer.

<sup>74</sup> Under New Rules 9231(c) and 9331(a)(2), the Chief Hearing Officer and Exchange Review Council or Review Subcommittee, respectively, may determine that a matter be designated as an Extended Hearing or Extended Proceeding, and that such matter be considered by an Extended Hearing Panel or Extended Proceeding Committee. Under

order a hearing on his or her own motion.<sup>75</sup> Should a hearing be waived and the Hearing Officer or Hearing Panel declines [sic] to hold a hearing, the matter may be considered by the Hearing Panel on the record, as defined in New Rule 9267.<sup>76</sup> Should the hearing process proceed, it is governed by the New Rule 9200 Series. The hearing process concludes with either all of the causes of action in the matter summarily disposed of on motion,<sup>77</sup> acceptance of an offer of settlement,<sup>78</sup> or the issuance of a decision by the Hearing Panel.<sup>79</sup>

### The Exchange Review Council

The Exchange is eliminating two committees under the By-Laws and adopting the Exchange Review Council in their stead. The Exchange Review Council will have, in all material respects, the same broad authority as the BX and Nasdaq Review Councils.<sup>80</sup> As such,

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New Rule 9231(c), in making its determination, the Chief Hearing Officer will consider complexity of the issues involved, the probable length of the hearing, or other factors that the Chief Hearing Officer deems material. Under New Rule 9331(a)(2), in making its determination, the Exchange Review Council or the Review Subcommittee will consider the volume and complexity of the certified record, or other factors that the Exchange Review Council or the Review Subcommittee deems material. For purposes of this filing, references to Hearing Panels and Hearing Panelists include references to Extended Hearing Panels and Extended Hearing Panelists, and references to Subcommittees and Subcommittee members include references to Extended Proceeding Committees and Extended Proceeding Committee members, unless otherwise noted.

<sup>75</sup> See New Rule 9120 for definitions of these terms.

<sup>76</sup> New Rule 9221(c).

<sup>77</sup> After a hearing on the merits has commenced, either the Respondent or the Phlx Regulation Department, the Department of Enforcement or the Department of Market Regulation may make a motion for summary disposition of any or all of the causes of action in the complaint with respect to that Respondent or defenses raised in that Respondent's answer only with leave of the Hearing Officer. See New Rule 9264.

<sup>78</sup> New Rule 9270.

<sup>79</sup> New Rule 9268.

<sup>80</sup> The Review Councils of BX and Nasdaq preside over matters involving appeals of their respective Rules 4612 (Registration as an Equities/Nasdaq Market Maker), 4619 (Withdrawal of Quotations), 4620 (Voluntary Termination of Registration), and 11890 (Clearly Erroneous Transactions). See Rules 0120(m) of BX and Nasdaq. Moreover, the



the new Exchange Review Council will be charged with ensuring the consistent and fair application of the rules pertaining to discipline of Members, Member Organizations, and Associated Persons, and considering and making recommendations to the Board on policy and rule changes relating to business and sales practices of Members, Member Organizations, and Associated Persons and enforcement policies, including policies with respect to fines and other sanctions.<sup>81</sup> The policy function of the Exchange Review Council is similar to that of the BCC, yet broader in scope.<sup>82</sup> The Exchange is also eliminating the Market Operations Review

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Nasdaq Review Council presides over matters involving appeals of Nasdaq Options Rule Chapter V Section 6 (Obvious and Catastrophic Errors). See Nasdaq Rule 0120(m). The Exchange Review Council presides over matters involving, in part, appeals of Rules 124 (Disputes-Options), 1092 (Obvious Errors and Catastrophic Errors), 3219 (Withdrawal of Quotations), 3220 (Voluntary Termination of Registration), and 3312 (Clearly Erroneous Transactions). See New Rule 1(k). BX and Nasdaq Rules 4619, 4620 and 11890 are materially identical to Exchange Rules 3219, 3220 and 3312, respectively. Nasdaq Options Rule Chapter V, Section 6, and Exchange Rule 1092 both address obvious and catastrophic errors on their respective options markets. Last, Exchange Rule 124 is unique to Phlx as it addresses disputes occurring on and relating to the Exchange's trading floor. Neither BX nor Nasdaq have [sic] a physical trading floor.

<sup>81</sup> See New Phlx By-Law, Article V, Sec. 5-3(b)(i). The Exchange Review Council also may consider and make recommendations to the Board on policy and rule changes relating to business and sales practices of members, member organizations and associated persons and enforcement policies, including policies with respect to fines and other sanctions, may advise the Board on regulatory proposals and industry initiatives relating to quotations, execution, trade reporting, and trading practices and may advise the Board in its administration of programs and systems for the surveillance and enforcement of rules governing member, member organization and associated person conduct and trading activities in the national securities exchange operated by the Company. Id. The same provisions of the BX and Nasdaq by-laws only apply this role as it relates to their respective members. The Exchange notes that programs and systems for the surveillance and enforcement of rules governing member conduct and trading activities, as described in the BX and Nasdaq by-laws, implicitly apply to such conduct and activity of associated persons. Thus, the proposed addition of Members and Associated Persons to this provision of New Phlx By-Law, Article V, Sec. 5-3(b)(i), is done for clarification purposes.

<sup>82</sup> Specifically, the proposed amended By-Laws provide that the Exchange Review Council may be authorized to: act for the Board with respect to appeals or reviews of disciplinary proceedings; act for the Board with respect to statutory disqualification proceedings; act for the Board with respect to membership proceedings; review offers of settlement, letters

Committee, whose duties will be the responsibility of the Exchange Review Council, which is discussed in greater detail below.

In its adjudicatory role, the Exchange Review Council will serve as an appellate body, with jurisdiction to: (i) review decisions issued in disciplinary proceedings,<sup>83</sup> statutory disqualification proceedings, or membership proceedings;<sup>84</sup> (ii) review an offer of settlement, a letter of acceptance, waiver, and consent, and a minor rule violation plan letter;<sup>85</sup> (iii) review the exercise of exemptive authority;<sup>86</sup> and (iv) review such other proceedings or actions as may be authorized by the Exchange rules.<sup>87</sup> As such, the Exchange Review Council will perform a role identical to that of the Review Councils of BX and Nasdaq, and FINRA's NAC. The NAC reviews decisions rendered by Hearing Panels in FINRA disciplinary proceedings and Member Regulation Department decisions rendered in membership proceedings involving FINRA members, among other things.<sup>88</sup>

Likewise, the Exchange Review Council will review decisions issued by Hearing Panels concerning disciplinary matters and Membership Department decisions in membership

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of acceptance, waiver and consent, and minor rule violation plan letters; exercise exemptive authority; consider and make recommendations to the Board on policy and rule changes relating to business and sales practices of Members, Member Organizations and Associated Persons and enforcement policies, including policies with respect to fines and other sanctions; exercise other such powers and duties as the Board deems appropriate. See New Phlx By-Law, Article V, Sec. 5-3(b)(i).

<sup>83</sup> See New Rule 9300 Series.

<sup>84</sup> See New Rule 9520 Series.

<sup>85</sup> See New Rule 9216.

<sup>86</sup> New Rule 9600 Series.

<sup>87</sup> New Phlx By-Law, Article V, Sec. 5-3(b)(i).

<sup>88</sup> FINRA Regulation, Inc. By-Law, Article V, Sec. 5.1.

proceedings concerning Members, Member Organizations, [sic] Associated Persons.<sup>89</sup> Hearing Panel decisions may be appealed to the Exchange Review Council by either the respondent or the Phlx Regulation Department, the Department of Enforcement or the Department of Market Regulation.<sup>90</sup> Appeals must be made in writing within 25 days after service of the decision.<sup>91</sup>

The Exchange Review Council may also call a Hearing Panel decision for review on its own motion, except that default decisions issued pursuant to New Rule 9269 shall be subject to a call for review by the CRO and a decision with respect to a Member, Member Organization, or Associated Person that is an affiliate of the Exchange within the meaning of Rule 985 may not be called for review.<sup>92</sup> Decisions of the Exchange Review Council are final unless called for review by the Board.<sup>93</sup> This process is consistent with the current process by which the BX and Nasdaq Boards may call for review a decision made by their Review Councils arising from their respective disciplinary and membership rules, as well as the process followed by the FINRA Board of Directors in its review of such decisions issued by the NAC.<sup>94</sup>

The Exchange notes that both Nasdaq and BX eliminated their respective Market Operations Review Committees and transferred those committees' responsibilities to their Review Councils.<sup>95</sup> Accordingly, the Exchange is proposing to eliminate its Market Operations

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<sup>89</sup> New Phlx By-Law, Article V, Sec. 5-3(b)(i).

<sup>90</sup> New Rule 9311(a).

<sup>91</sup> Id.

<sup>92</sup> New Rule 9312.

<sup>93</sup> New Rules 923(a)(x)(C), 9349(c), and 9351.

<sup>94</sup> See Nasdaq Rules 1016, 9349(c) and 9351, BX Rules 1016, 9349(c) and 9351, and FINRA Rules 1016, 9349(c) and 9351.

<sup>95</sup> See Securities Exchange Act Release No. 72151 (May 12, 2014), 79 FR 28571 (May 16, 2014) (SR-NASDAQ-2014-048) and Securities Exchange Act Release No. 72149 (May 12, 2014), 79 FR 28564 (May 16, 2014) (SR-BX-2014-024).

Review Committee (“MORC”) and include its responsibilities within those of the new Exchange Review Council. The MORC is responsible for considering appeals of determinations made pursuant to Exchange Rules 124, 1092, 3219, 3220, and 3312. Decisions of the MORC in these matters are not appealable,<sup>96</sup> however, determinations of the MORC with respect to Rule 3312 may be arbitrated.<sup>97</sup> The By-Laws require that the MORC be comprised of a number of Member Representative members that is equal to at least 20 percent of the total number of members of the MORC.<sup>98</sup> Moreover, the By-Laws require that no more than 50 percent of the members of the MORC be engaged in market making activity or employed by a Member whose revenues from market making exceed 10 percent of its total revenues.<sup>99</sup> The By-Laws do not provide a description of what is a quorum for purposes of holding a meeting of the MORC, however, the committee has adopted a three member quorum requirement.<sup>100</sup>

### **Structure of the New Rules**

The Exchange is adopting a New Rule 8000 and 9000 Series, which are modeled on the BX and Nasdaq Rules, and which replace the current Rule 960 Series.

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<sup>96</sup> Unlike disciplinary proceedings under the New Rule 9000 Series, speedy resolution of matters under the MORC’s jurisdiction is important to ensuring fair and equitable treatment of Members.

<sup>97</sup> See Rule 3312(c)(3).

<sup>98</sup> Phlx By-Law, Article V, Sec. 5-3(d).

<sup>99</sup> Id.

<sup>100</sup> Rule 3312(c)(2) expressly requires a panel to consist of three or more members of the MORC, provided that no more than 50 percent of the members of any panel are directly engaged in market making activity or employed by a Member firm whose revenues from market making activity exceed ten percent of its total revenues. The rule also states that in no case shall a MORC Panel include a person affiliated with a party to the trade in question. The amended Exchange By-Laws define an Exchange Review Council quorum for the transaction of business with regard to an appeal of proceedings involving Exchange Rules 124, 1092, 3219, 3320, and 3312 (currently under the MORC’s jurisdiction) [sic] shall consist of three members of the Exchange Review Council.

The New Rule 8000 Series is titled “Investigations and Sanctions,” and it governs the regulation of Member Organizations, Members and Associated Persons, investigations and sanctions. With respect to regulation of Member Organizations, Members and Associated Persons, the New Rule 8000 Series generally describes the regulatory contract between the Exchange and FINRA,<sup>101</sup> and requires Member Organizations to keep and maintain current paper or electronic copies of both the FINRA and Exchange manuals.<sup>102</sup>

The New Rule 8200 Series concerns the investigative process. It grants the Phlx Regulation Department, including FINRA staff, the right to require Members, Member Organizations, Associated Persons and persons subject to the Exchange’s jurisdiction to provide information and to testify under oath,<sup>103</sup> and to permit inspections of their books and records, and accounts with respect to any matter involved in the investigation, complaint, examination, or proceeding.<sup>104</sup> The New Rule 8200 Series also extends this authority to investigations conducted by a domestic or foreign SRO, association, securities or contract market, or regulator of such markets with which the Exchange has entered into an agreement providing for the exchange of information and other forms of material assistance solely for market surveillance, investigative, enforcement, or other regulatory purposes.<sup>105</sup> The New Rule 8211 Series imposes a new obligation on member organizations to submit certain trade data<sup>106</sup> to the Phlx Regulation

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<sup>101</sup> New Rule 8001.

<sup>102</sup> New Rule 8110.

<sup>103</sup> New Rule 8210(a)(1).

<sup>104</sup> New Rule 8210(a)(2).

<sup>105</sup> New Rule 8210(b).

<sup>106</sup> The data required is based on whether the transaction was proprietary or effected for a customer, however, the Phlx Regulatory Department also may require a member organization to submit other information in an automated format. See New Rule 8211(b) – (d).

Department, including FINRA staff, in such an automated format as the New Rule prescribes.

Pursuant to the New Rule 9600 Series, the Exchange may exempt a Member Organization from this requirement for good cause shown.

The New Rule 8300 Series describes the nature and effect of sanctions the Exchange may impose on a Member, Member Organization or Associated Person after compliance with the New Rule 9000 Series, including the circumstances under which the Exchange will release information concerning a disciplinary matter.<sup>107</sup> The New Rule 8300 Series also provides the requirements concerning payment of fines, other monetary sanctions, and the consequences of non-payment.<sup>108</sup>

The New Rule 9000 Series is titled “Code of Procedure.” It governs proceedings for: disciplining Members, Member Organizations, and Associated Persons; regulating Member Organizations experiencing financial or operational difficulties; summary or non-summary suspensions, cancellations, bars, prohibitions, or limitations; and obtaining relief from the eligibility requirements of the Exchange By-Laws and the Exchange Rules. The New Rule 9000 Series generally describes the RSA between the Exchange and FINRA.<sup>109</sup>

The New Rule 9100 Series describes the application and purpose of the New Rule 9000 Series, including the types of proceedings covered by the New Rules,<sup>110</sup> the rights, duties, and

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<sup>107</sup> New IM-8310-3.

<sup>108</sup> See New Rule 8320. New Rule 8330 provides that a Member, Member Organization or Associated Person that is disciplined pursuant to New Rule 8310 shall bear such costs of the proceeding, as the Adjudicator deems fair and appropriate under the circumstances.

<sup>109</sup> See New Rule 9001.

<sup>110</sup> See New Rule 9110.

obligations of Members, Member Organizations and Associated Persons,<sup>111</sup> jurisdiction,<sup>112</sup> defined terms,<sup>113</sup> and rules concerning the filing and service of papers.<sup>114</sup> The New Rule 9100 Series also provides rules concerning proceedings, including appearance and practice,<sup>115</sup> withdrawal by attorney or representative,<sup>116</sup> ex parte communications,<sup>117</sup> separation of functions among Adjudicators and Interested Staff,<sup>118</sup> rules of evidence and official notice,<sup>119</sup> motions,<sup>120</sup> rulings on procedural matters,<sup>121</sup> and interlocutory review.<sup>122</sup>

The New Rule 9200 Series sets forth the disciplinary process, including rules concerning the authorization and issuance of a complaint,<sup>123</sup> the briefing and hearings process,<sup>124</sup> issuance of

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<sup>111</sup> Id.

<sup>112</sup> Id.

<sup>113</sup> See New Rule 9120. The Exchange notes that it is adopting a more comprehensive definition of “Interested Staff” under New Rule 9120(t) than the comparable definitions under BX and Nasdaq. Specifically, the Exchange is adopting new text that accounts for the role of the Phlx Regulation Department, including the involvement of employees thereof. Thus, the proposed new definition will include all individuals that should be considered as “Interested Staff” for purposes of the New Rule 9000 Series.

<sup>114</sup> See New Rules 9131 – 9138.

<sup>115</sup> See New Rule 9141.

<sup>116</sup> See New Rule 9142.

<sup>117</sup> See New Rule 9143.

<sup>118</sup> See New Rule 9144.

<sup>119</sup> See New Rule 9145.

<sup>120</sup> See New Rule 9146.

<sup>121</sup> See New Rule 9147.

<sup>122</sup> See New Rule 9148.

<sup>123</sup> See New Rules 9211 and 9212.

<sup>124</sup> See New Rules 9215 – 9267.

a decision,<sup>125</sup> the settlement process,<sup>126</sup> and sanctions for contemptuous conduct.<sup>127</sup> The New Rule 9200 Series also includes rules concerning adjudication that imposes [sic] a temporary or permanent cease-and-desist order.<sup>128</sup>

The New Rule 9300 Series sets forth the process for review of disciplinary proceedings by the Exchange Review Council and the Board.<sup>129</sup> The New Rule 9300 Series also describes the role of Counsel to the Exchange Review Council, review of Counsel decisions,<sup>130</sup> and the time when sanctions become effective,<sup>131</sup> including when a Respondent appeals a decision to the Securities and Exchange Commission.<sup>132</sup>

The New Rule 9400 Series provides the process for expedited client suspension proceedings, involving alleged violations of New Rule 774 (Disruptive Quoting and Trading Activity Prohibited).

The New Rule 9500 Series provides the process for proceedings other than formal disciplinary proceedings. The New Rule 9520 Series sets forth procedures for a person to become or remain associated with a Member Organization, notwithstanding the existence of a statutory disqualification, and provides the process for a Member, Member Organization, or Associated Person to obtain relief from the eligibility or qualification requirements. The New

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<sup>125</sup> See New Rules 9268 and 9269.

<sup>126</sup> See New Rule 9270.

<sup>127</sup> See New Rule 9280.

<sup>128</sup> See New Rules 9290 and 9291.

<sup>129</sup> The New Rules include provisions for the appeal of a matter to the Exchange Review Council (New Rule 9311), review proceedings initiated by the Exchange Review Council (New Rule 9312), and discretionary review by the Board (New Rule 9350 Series).

<sup>130</sup> See New Rule 9313.

<sup>131</sup> See New Rule 9360.

<sup>132</sup> See New Rule 9370.



Rule 9550 Series<sup>133</sup> provides the process followed for violations of Phlx rules subject to expedited proceedings, including: failures to provide information or keep information current (New Rule 9552); failures to pay Exchange dues, fees and other charges (New Rule 9553); failures to comply with an arbitration award or related settlement or an order of restitution or settlement providing for restitution (New Rule 9554); failures to meet the eligibility or qualification standards or prerequisites for access to services (New Rule 9555); failures to comply with temporary and permanent cease-and-desist orders (New Rule 9556); procedures for

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<sup>133</sup> The Exchange is proposing to include both the Phlx Regulation Department and FINRA as authorized to provide notice under the various expedited proceedings Rules. The Exchange notes that the analogous BX and Nasdaq expedited proceedings Rules state that notice is to be provided by those exchanges' respective Regulation Department staff only. See, e.g., BX and Nasdaq Rules 9553(b). FINRA, acting on behalf of the Exchange, is authorized to provide such notice under BX and Nasdaq rules, notwithstanding the omission in the rule text. Thus, including both Phlx Regulation Department staff as well as FINRA under the service of notice provisions of the expedited hearings rules will avoid any confusion caused by the omissions in the BX and Nasdaq rule text, and will make it clear that such notices may be issued by either the Exchange or FINRA. Similarly, the Exchange is proposing to adopt consistent notification requirements under New Rule 9550 Series. BX and Nasdaq Rules 9552(f) and 9556(g) provide a process by which a member or person subject to a limitation or suspension, respectively, may seek termination of the limitation or suspension. Under those rules, a written request for such a termination must be filed with "the head of the Exchange department or office that issued the notice or, if another Exchange department or office is named as the party handling the matter on behalf of the issuing department or office, with the head of the Exchange department or office that is so designated. The appropriate head of the department or office may grant relief for good cause shown." By contrast, BX and Nasdaq Rules 9552(f), 9553(g), 9554(g), and 9558(g) speak of filing a request for termination a limitation, prohibition or suspension, as applicable, with "the head of the FINRA department or office that issued the notice or, if another FINRA department or office is named as the party handling the matter on behalf of the issuing department or office, with the head of the FINRA department or office that is so designated. The appropriate head of the department or office may grant relief for good cause shown." The Exchange is proposing to adopt a consistent notification requirement under the respective New Rule 9550 Series by requiring notice to the "Exchange department or FINRA department." The Exchange notes that, in practice, a FINRA department may be included as the proper department for notice based on the respective RSAs of BX, Nasdaq and the Exchange. See BX Rule 9001, Nasdaq Rule 9001, and proposed New Rule 9001.

regulating activities under Rule 703 regarding a Member Organization experiencing financial or operational difficulties (New Rule 9557);<sup>134</sup> summary proceedings for actions authorized by Section 6(d)(3) of the Act (New Rule 9558); and the hearing procedures for expedited proceedings under the New Rule 9550 Series.

The New Rule 9600 Series provides procedures followed when a Member Organization seeks exemptive relief pursuant to any Exchange Rule that references the New Rule 9600 Series.

The New Rule 9800 Series provides the process followed by the Exchange in administering temporary cease-and-desist orders, including the initiation of proceeding to issue such an order,<sup>135</sup> service thereof,<sup>136</sup> subsequent review of the order by the Hearing Panel,<sup>137</sup> the consequences of non-compliance,<sup>138</sup> and the process for seeking Commission review of the order.<sup>139</sup>

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<sup>134</sup> Currently, the Exchange has emergency authority to suspend a member organization pursuant to Phlx By-Law, Article VII, Sec. 7-5(b), which provides “The Board of Directors, or such person or persons or committee as may be designated by the Board of Directors, in the event of an emergency or extraordinary market conditions, shall have the authority to take any action regarding...the operation of any or all offices or systems of Members and Member Organizations, if, in the opinion of the Board of Directors or the person or persons hereby designated, such action is necessary or appropriate for the protection of investors or the public interest or for the orderly operation of the marketplace or the system.” The Exchange does not have an analogous rule that relates to this authority. As such, New Rule 9557 provides a more specific description of the exercise of this authority in instances where a Member Organization is experiencing financial or operational difficulties, including notice requirements, a hearing process, and a process for the removal or reduction of a requirement or restriction.

<sup>135</sup> New Rule 9810.

<sup>136</sup> Id.

<sup>137</sup> New Rule 9850.

<sup>138</sup> New Rule 9860.

<sup>139</sup> New Rule 9870.

## Specific Rule Changes

As discussed above, the Exchange is amending its By-Laws, deleting the Rule 960 Series, and adopting the New Rule 8000 and 9000 Series. As a consequence of these changes, the Exchange has amended or deleted other Rules, which are either not needed, duplicated elsewhere, or referenced the deleted rules or the BCC. Below is a description of the individual changes the Exchange is making to its Rules. The descriptions describe the current Rule, where the rule resides in the New Rules, and any differences between the current and New Rule.

- Phlx is proposing to amend its By-Laws by deleting Article V, Section 5-3(b), “The Board shall appoint a Business Conduct Committee” and replace it with a new Section 5-3(b) titled “The Board shall appoint an Exchange Review Council.” Current Section 5-3(b) describes the jurisdiction and composition requirements of the BCC. New Section 5-3(b), which is copied from Article VII of the BX By-Laws and Article VI of the Nasdaq By-Laws, describes the jurisdiction and composition requirements of the Exchange Review Council. The new rule text of Section 5-3(b) materially differs from Article VII of the BX By-Laws and Article VI of the Nasdaq By-Laws in that new Phlx By-Law expressly provides that the Exchange Review Council may advise the Board in its administration of programs and systems for the surveillance and enforcement of rules governing Member, Member Organization and Associated Person conduct and trading activities in the national securities exchange operated by Phlx. In contrast, the related provisions of the BX and Nasdaq By-Laws only describe such an advisory role with respect to their members. The Exchange believes that BX and Nasdaq consider this Exchange Review Council advisory role to their respective boards to implicitly extend to associated persons. The Exchange also believes that this Exchange Review Council advisory role should include both

Member Organizations and their Associated Persons, including Members.

Consequently, the Exchange is expressly including Members and Associated Persons in this provision. Otherwise, the new rule text of Section 5-3(b) is identical in all material respects to that of Article VII of the BX By-Laws and Article VI of the Nasdaq By-Laws, differing in the By-Laws and rule numbers cited due to the Exchange's different numbering conventions. The Exchange notes that the majority of these Rules align with the comparable rules of BX and Nasdaq (compare, e.g. Phlx Rule 3312 "Clearly Erroneous Transactions" with BX and Nasdaq Rules 11890 "Clearly Erroneous Transactions"); however, the Exchange includes Rule 124 "Disputes-Options" under the Exchange Review Council's jurisdiction, which is currently under the jurisdiction of the MORC as discussed above and which neither BX nor Nasdaq have [sic]. In addition, BX and Nasdaq have a Rule 4612, which concerns registration as a market maker and which the Exchange does not have an analogue. The Exchange notes that appeals of determinations made pursuant to BX and Nasdaq Rules 4612 were reviewed by their respective MORCs prior to consolidation into their Review Councils. Similarly, appeals of determinations made pursuant to Exchange Rule 124 are currently reviewed by the Exchange's MORC. The Exchange notes that Section 5-3(b)(iv) of the amended By-Laws provides that each Exchange Review Council member shall hold office for a term of three years or until a successor is duly appointed and qualified, except in the event of earlier termination from office by reason of death, resignation, removal, disqualification, or other reason. Further, Section 5-3(b)(iv) provides that the Exchange Review Council shall be divided into three classes. To simplify the process of appointing Exchange

Review Council members, the Exchange is proposing to use the members of the BX and Nasdaq Review Councils as the members of the Exchange Review Council, with the same terms and classes as those members have on the BX Review Council. The Exchange notes that this will ease the administration and recruitment of members by harmonizing their terms, and thus when new members must be approved by the exchange boards.

- Phlx is proposing to amend its By-Laws by deleting Article V, Section 5-3(d), and holding it in reserve. Section 5-3(d) establishes the MORC and its functions, which have been incorporated into new Section 5-3(b).
- Existing Rule 1 provides definitions for purposes of the rules of the Board, and rules and regulations of standing committees of the Exchange.
  - The Exchange is amending the definition of the terms “Associated Person” and “Person Associated with a Member Organization” to include, for purposes of the New Rule 8000 and 9000 Series, an amended definition of what currently resides at Rule 960.1, Interpretation and Policies .01. The Exchange is proposing to replace use of the term “associated person of a member,” which as described below is incorrectly used at Rule 960.1, Interpretation and Policies .01 since there are no persons associated with a Member, with the defined term “associated person.” The Exchange is also proposing to make it clear that, for purposes of the 8000 and 9000 Rule Series, the term “person associated with a member organization” or “associated person” shall have the same meaning as the term “persons associated with a member” or “associated person of a member,” respectively, as provided in Section 3(a)(21) of the Exchange Act. The Exchange

notes that the proposed changes to the defined terms does [sic] not change how they are presently applied.

- The Exchange is defining the new term “Code of Procedure” as the procedural rules contained in the New Rule 9000 Series.
- The Exchange is amending the definition of the term “Commission” to include the term “SEC.”
- The Exchange is defining the new term “Exchange Review Council,” which is copied from BX and Nasdaq Rules 0120(m). The Exchange notes that item (6) of the new definition differs from the BX and Nasdaq items (6) in that it cites the analogous Rules of the Exchange, which have different rule numbers. In addition, and as noted above in the By-Laws discussion, the rules for which the Exchange Review Council is the appellate body, which are listed under item (6) of each of the three exchanges, derive from the responsibilities of the former BX and Nasdaq MORCs that were incorporated into their Review Councils, and such responsibilities of the Exchange’s current MORC. Accordingly, to the extent those rules differ, so do the citations under the Exchange Review Council definitions of the three exchanges.
- The Exchange is amending the definition of “Member” to add rule text that clarifies that a Member is a natural person and must be a person associated with a Member Organization, and, as such, any references to Exchange to the rights or obligations of an Associated Person or person associated with a Member Organization also includes a Member.

- The Exchange is eliminating references to the phase-in period of Rule 611 of Regulation NMS under the definition of “Protected Bid,” since the phase-in period has since past. As a consequence, the Exchange is also deleting definitions of “Nasdaq Global Market Security” and “Nasdaq Capital Market Security,” which were solely referenced under the deleted portions of the definition of “Protected Bid.”
- Rule 50 concerns the consequences of a Member’s, Member Organization’s, or Associated Person’s failure to pay dues, fees, and other charges. Phlx is replacing the Rule with New Rule 9553, which is materially identical to the old Rule, except for the notice provisions under Rule 50(b), which require that service of a notice of suspension, cancellation or bar be done in accordance with Rule 960.6 (Summary Disposition Proceedings). Rule 960.6(b) requires that notice and a copy of a summary decision is provided to Respondents in accordance with Rule 960.11. Rule 960.11, in turn, allows service on a Respondent or Respondent’s Counsel either personally or by deposit with the United States Postal Service (postage pre-paid via registered or certified mail), by courier service addressed to Respondent’s Counsel or the Respondent at his address (as it appears on the books and records of the Exchange), or, upon mutual written consent of the parties, by electronic delivery. By contrast, New Rule 9553(b) requires notice in accordance with Rule 9134 (Methods of, Procedures for Service) or by facsimile or email. Rule 9134 is generally consistent with current requirements under Rule 50; however, Rule 9134 provides more specificity on the source of the addresses that may be used for service, types of allowable service by U.S. Postal Service, and when service is complete.

- Rule 60 provides the process for assessing fines pursuant to the Order and Decorum regulations under Section H of the Option Floor Procedure Advices and Order & Decorum Regulations. The Order and Decorum regulations provide fines assessed in lieu of formal disciplinary proceedings for conduct relating to the administration of order, decorum, health, safety and welfare on the Exchange. The Exchange is proposing to adopt Rules 9216(c)(1) and (2) to address the process for administering violations of the Order and Decorum regulations under Section H of the Option Floor Procedure Advices.
- Rule 60(a)(i) provides an Options Exchange Official authority to assess fines on Members, Member Organizations, and Associated Persons for breaches of the Order and Decorum regulations. In addition, the rule permits the Options Exchange Official to refer the matter to the BCC, where it will proceed in accordance with the Rule 960 Series. The Exchange is moving Rule 60(a)(i) to New Rule 9216(c)(1) with minor changes. Specifically, the Exchange is replacing reference to the BCC with reference to the Department of Enforcement or the Department of Market Regulation, which are the bodies responsible for bringing formal disciplinary action under the BX and Nasdaq rules. The Exchange is also providing that an Options Exchange Official, as a representative of the Phlx Regulation Department, may instead request authorization for the issuance of a complaint from the ODA directly.<sup>140</sup> In addition, the Exchange is replacing a reference to its current disciplinary Rules 960.1 – 960.12 with reference to the New Rule 8000 and 9000 Series.

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<sup>140</sup> See notes 47 and 55, supra.



- Rule 60(a)(ii) provides Exchange staff authority to assess fines on Members, Member Organizations, or persons associated with Member Organizations for breaches of the Order and Decorum regulations and is otherwise identical in all respects to Rule 60(a)(i), including permitting Exchange staff to refer the matter to the BCC, where it will proceed in accordance with the Rule 960 Series. The Exchange is moving Rule 60(a)(ii) to New Rule 9216(c)(1), which combines Rules 60(a)(i) and (ii), as modified by the minor changes described above. The Exchange is also providing that Exchange staff, acting as a representative of the Phlx Regulation Department, may instead request authorization of a complaint from the ODA directly.<sup>141</sup>
- Rule 60(b)(i) provides Options Exchange Officials and officers of the Exchange authority exclude a Member or Associated Person from the trading floor for breaches of Order and Decorum regulations that occurred on the trading floor, or on the premises immediately adjacent to the trading floor. In particular, Members and Associated Persons are excluded if they pose an immediate threat to the safety of persons or property, are seriously disrupting Exchange operations, or are in possession of a firearm. Under the rule, Members or Associated Persons so excluded may be excluded for a period of up to five business days. The Exchange is moving the Rule to New Rule 9216(c)(2), with only a minor change to delete text that defines a “Member” as either a Member or a person associated with a Member Organization. As described above, a Member must be a person associated with a Member Organization; however, use of the term to refer to both

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<sup>141</sup>

Id.

types of Associated Persons may be confusing. Thus, the Exchange is instead including both terms individually.

- Rule 60(b)(ii)<sup>142</sup> defines an “officer of the Exchange” for purposes of Rule 60 to mean an officer who is a vice president or higher. The Exchange is moving the rule unchanged to New Rule 9216(c)(2)(A).
- Rule 60(b)(iii) defines the “premises immediately adjacent to the trading floor” to include: (1) all premises other than the trading floor that are under Exchange control, and (2) premises in the building where the Exchange maintains its principal office and place of business, namely FMC Tower, 2929 Walnut Street, Philadelphia, Pennsylvania. The Exchange is moving the rule unchanged to New Rule 9216(c)(2)(B).
- Rule 60(b)(iv) provides that exclusion from the floor may not be the exclusive sanction for breaches of the Order and Decorum regulations, which include, in addition to exclusion, a fine or referral to the BCC, where it shall proceed in accordance with the Rule 960 Series. The Exchange is moving the Rule to New Rule 9216(c)(2)(C) with minor changes. Specifically, the Exchange is replacing reference to referring matters to the BCC with reference to the Department of Enforcement or the Department of Market Regulation, which are the appropriate bodies responsible for bringing formal disciplinary action under the BX and Nasdaq rules. The Exchange is also providing that the Phlx Regulation Department may instead request authorization of a complaint from the ODA

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<sup>142</sup> The Exchange notes that Rule 60(c) was mistakenly placed between Rules 60(b)(i) and (ii). See Securities Exchange Act Release No. 61207 (December 18, 2009), 74 FR 69185 (December 30, 2009) (SR-Phlx-2009-84).

directly.<sup>143</sup> In addition, the Exchange is replacing references to its current disciplinary rules with the New Rule 8000 and 9000 Series.

- Rule 60(c) provides the process for Expedited Hearings for Members and Associated Persons that are excluded for a period exceeding forty-eight hours. Pursuant to the Rule, an expedited hearing will be held before the Chair of the BCC or a member of the Committee designated by the Chair within forty-eight business hours after the Member's or Associated Person's exclusion from the trading floor. The Rule further provides the required contents of the notice to the Member or Associated Person and sets forth the Member's or Associated Person's right to be represented by counsel. The Rule also provides the hearing process, issues to be considered by the adjudicator, and the timing and form of the determination. The Exchange is moving the Rule to New Rule 9216(c)(2)(D) with minor changes. Specifically, the Exchange is changing who is authorized to be an Expedited Hearing Officer to either the Chair of the Exchange Review Council or a member thereof. The Exchange believes that members of the Exchange Review Council are best suited to be Expedited Hearings panelist because of their expertise. Moreover, violations of Order and Decorum rules are not appealable to the Exchange Review Council, thus members thereof will not be conflicted in any subsequent appeal. The Exchange is also adding clarifying text to New Rule 9216(c)(2)(E)(ii) that describes in greater detail the exception to reporting provided by Rule 19b-1(c).

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<sup>143</sup> See notes 47 and 55, supra.

- Rule 60, Commentary (a) provides the procedures to be followed in cases where a pre-set fine of up to \$10,000 is summarily assessed. The Exchange is moving the Commentary under New Rule 9216(c)(1).
  - Rule 60, Commentary (a).01 requires the notice of the fine for breach of such regulations to be given by the issuance of a written citation, served by Exchange staff. The commentary provides that the cited party may accept or contest the written citation. The Exchange is moving the Commentary unchanged to New Rule 9216(c)(1)(A).
  - Rule 60, Commentary (a).02 provides the notice requirements for hearings arising from contested citations. The Exchange is moving the Commentary unchanged to New Rule 9216(c)(1)(B).
  - Rule 60, Commentary (a).03 provides the hearing recordation requirements. The Exchange is moving the Commentary unchanged to New Rule 9216(c)(1)(C).
  - Rule 60, Commentary (a).04 provides the procedure for hearings of contested fines. The Exchange is moving the Commentary with minor changes to New Rule 9216(c)(1)(D). Specifically, the Exchange is replacing the Chair of the BCC as the individual responsible for appointing a Hearing Director under the Rule with the Chair of the Exchange Review Council.
  - Rule 60, Commentary (a).05 provides the nature and timing of the Hearing Director's determination upon conclusion of the hearing. The Exchange is moving the Commentary unchanged to New Rule 9216(c)(1)(E).

- Rule 60, Commentary (a).06 provides the conditions for assessing a forum fee. The Exchange is moving the Commentary to New Rule 9216(c)(1)(F), with only a minor change to update a citation to Rule 60 with New Rule 9216(c).
  - Rule 60, Commentary (a).07 states that there is no right of appeal of a hearing determination under the Rule. The Exchange is moving the Commentary unchanged to New Rule 9216(c)(1)(G).
  - Rule 60, Commentary (a).08 states that the Exchange will file a report in appropriate form with the SEC for any fine assessed under the Rule that is not contested and does not exceed \$1,000. The Exchange is moving the Commentary, with only minor changes, to New Rule 9216(c)(1)(H) to clarify that the exemption to SEC reporting arises from SEC Rule 19d-1(c)(1).
- Rule 60, Commentary (b) provides the procedures to be followed when a Member or an Associated Person is to be excluded from the trading floor. The Exchange is moving the rule to New Rule 9216(c)(2)(E).
  - Rule 60, Commentary (b).01 provides that the determination that a Member or an Associated Person shall be excluded is final and that there shall be no appeal from such determination. The Exchange is moving the Rule unchanged to New Rule 9216(c)(2)(E)(i).
  - Rule 60, Commentary (b).02 notes that the Exchange will file a report in appropriate form with the SEC, except in cases where a clerical employee is excluded for a breach of the Order and Decorum regulations. The Exchange is moving the Rule unchanged to New Rule 9216(c)(2)(E)(ii).

- RULE 60—REGULATION AND FINE SCHEDULE provides that most violations of the Order and Decorum Code are handled by a pre-set fine and/or sanction, and an Options Exchange Official or Exchange staff may refer the matter to the BCC for formal disciplinary proceedings. The Rule also provides that in the case of repeat violations of a regulation by the same individual, the amount of the fine is determined by the number of such violations which have occurred within the year immediately preceding the current violation. The Exchange is moving the Rule to New Rule 9216(c), with minor changes to cite the new disciplinary rules and to note that referrals for formal disciplinary proceedings are made to either the Department of Enforcement or the Department of Market Regulation. The Exchange is also providing that an Options Exchange Official or Exchange Staff, as a representative of the Phlx Regulation Department, may instead request authorization of a complaint from the ODA directly.<sup>144</sup>
- The Rule 70 Series concerns insolvency of Members and Member Organizations, providing the Exchange with authority to suspend the permit of a Member that fails to perform its contracts or is deemed insolvent, and to suspend the permit of a Member or Member Organization that has failed to meet his or its engagements or is insolvent. See Rules 70 and 71. The Rule 70 Series consists of Rules 70 through 76, which provide the processes for suspending and resolving suspensions due to insolvency. These rules also provide the rights and obligations of those subject to suspension. This series of rules were significantly more important in the days when the Exchange required seats to transact on the Exchange. Prior to demutualization, when the

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<sup>144</sup> See notes 47 and 55, supra.

Exchange issued seats, those seats could be leased. As a consequence, Members could be indebted to other Members for the right to lease a seat. Since the Exchange demutualized, there are no longer any seats, owners or lessors thereof. Today permits provide trading rights to Members and Member Organizations in lieu of the issuance of seats as property. Moreover, the Exchange collects fees owed by Members and Member Organizations via direct debit each month. Thus, these rules were designed to protect Members and the Exchange during a time when the relationships among Members, and between Members and the Exchange, resulted in much greater risk exposure if a Member became insolvent than is the case today. Under the New Rules, the Exchange will continue to have the authority to suspend a Member, Member Organization, or an Associated Person, which would include the ability to suspend the permit(s) associated with a Member Organization. Specifically, New Rule 9558(a)(2), which provides the Exchange's CRO with authority to provide written authorization to FINRA staff to issue on a case-by-case basis a written notice that summarily suspends a Member Organization, and its associated permit(s), who is in such financial or operating difficulty that FINRA staff determines and so notifies the Commission that the Member Organization cannot be permitted to continue to do business as a Member Organization with safety to investors, creditors, other Member Organizations, or the Exchange.<sup>145</sup> New Rule 9558 provides protections similar to the Rule 70 Series by preventing a Member Organization, and by extension its

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<sup>145</sup> Unlike the Rules 9558(a)(2) of BX and Nasdaq, the Exchange is including authority to suspend a Member Organization's associated permit. The Exchange notes that neither BX nor Nasdaq have [sic] trading permits. Permits allow Members and Member Organizations the ability to trade on the Exchange's [sic]. Consequently, suspension of a permit is vital to suspending a Member Organization, and its Associated Persons' ability to trade on the Exchange when subject to a suspension under Rule 9558(a)(2).

Associated Persons (including the Member(s) holding the permit(s)), from transacting on the Exchange while it is having financial or operating difficulty. Such financial or operating difficulty includes insolvency, which is what the Rule 70 Series concerns. Accordingly, the Exchange is proposing to delete the Rule 70 Series.

- Rule 70 permits the Exchange to suspend the permit of a Member upon notice of insolvency to the Exchange. Rule 71 permits the Exchange to suspend the permit of a Member if it appears to the BCC that the Member or its Member Organization has failed to meet its engagements or is insolvent. New Rule 9558(a) provides the CRO authority to direct FINRA to suspend a Member Organization, together with its permit(s), that is in such financial or operating difficulty that FINRA staff determines and so notifies the Commission that the Member Organization cannot be permitted to continue to do business as a Member Organization with safety to investors, creditors, other Member Organizations, or the Exchange. The Exchange notes that, although New Rule 9558 does not provide an affirmative obligation of Member Organizations to notify the Exchange that it is having financial difficulties, the Exchange does not believe that such an obligation is needed in light of the direct debit of Member Organization obligations and the prompt notice of a deficit in a Member Organization's account.
- Rule 72 concerns investigation of insolvency, and describes the Member's and Member Organization's obligation to cooperate with the BCC's investigation of insolvency. New Rule 8210 provides the Exchange similar authority to conduct an investigation and obligates a Member, Member Organization and Associated



Person to provide information and allow Phlx Regulation Department and FINRA staff to inspect and copy books and records and accounts of such Member, Member Organization or person.

- Rule 73 concerns the time for settlement of an insolvent Member, and allows the Membership Department to terminate a Member's permit if the Member fails to settle with its creditors and apply for reinstatement within six months from the time of such suspension, and permits the Board of Directors or their [sic] designee to extend the time of settlement for periods not exceeding one year each. In lieu of this process, the Exchange is instead applying the process under New Rule 9558, which provides an expedited process for resolving suspensions issued to Member Organizations having financial or operating difficulties that places [sic] the safety of investors, creditors other Member Organizations, or the Exchange at risk. In terms of settlement with its creditors, the Exchange, FINRA acting on behalf of the Exchange, or to the extent a hearing is held, a Hearing Panel, may determine the steps necessary to lift the suspension. If a Member Organization fails to satisfy those prerequisites, the Exchange may terminate the Member Organization and its permit(s).<sup>146</sup>
- Rule 74 concerns reinstatement of an insolvent Member, and requires Members applying for reinstatement of their permits to provide proof of settlement with their creditors, and provides the right to appeal a denial of reinstatement to the Board of Directors. New Rule 9558(d) provides that that [sic] a Member

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<sup>146</sup>

As discussed, a Member Organization may appeal a suspension issued pursuant to New Rule 9558(a)(2) to a Hearing Panel. Any decision thereof may be called for review by the Review Council pursuant to New Rule 9559(q). If a Member Organization fails to request a hearing timely, the suspension is final action of the Exchange.

Organization may submit a written request for a hearing and written request for a stay, the Chief Hearing Officer or Hearing Officer assigned to the matter [sic] finds good cause exists to stay the limitation, prohibition or suspension.<sup>147</sup> Under New Rule 9558(g), a Member Organization may file a written request for termination of the limitation, prohibition or suspension on the ground of full compliance with the notice or decision. The appropriate head of the Exchange or FINRA department or office may grant relief for good cause shown.

- Rule 75 allows the Exchange to proceed with [sic] against a Member whose permit is suspended, or its affiliated Member Organization, for any offense committed by the Member either before or after the announcement of the suspension as if the suspension had not occurred. New Rule 9110(d) sets forth the disciplinary jurisdiction of the Exchange, which provides similarly broad jurisdiction. Specifically, Rule 9110(d) provides that any Member, Member Organization, or any partner, officer, director or person employed by or associated with any Member Organization (the Respondent) who is alleged to have violated or aided and abetted a violation of the Securities Exchange Act of 1934 (Exchange Act), the rules and regulations thereunder, the By-Laws and Rules of the Exchange or any interpretation thereof, and the Rules, Regulations, resolutions and stated policies of the Board of Directors or any Committee of the Exchange, shall be subject to the disciplinary jurisdiction of the Exchange. Moreover, the rule further provides that disciplinary jurisdiction applies to any Member, or any partner, officer, director, or person employed by or associated

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<sup>147</sup> A Hearing held pursuant to New Rule 9558 follows the expedited hearing procedures provided by New Rule 9559.

with a Member Organization, and any Member Organization following the termination of such person's permit or the termination of the employment by or the association with a Member Organization of such Member or partner, officer, director or person, or following the deregistration of a Member Organization from the Exchange.

- Rule 76 concerns the rights of a Member suspended for insolvency, and provides that such a Member and its affiliated Member Organization shall be deprived during the suspension of all rights and privileges of a Member or Member Organization, except the right to have its business transacted at Members' commission rates. As described above, New Rule 9558(a) provides that a Member Organization, together with its associated permit(s), may be suspended. This effectively ensures that it is unable to conduct business on the Exchange. New Rule 9558(d) provides that such a suspension shall remain in effect unless, after a timely written request for a hearing and written request for a stay, the Chief Hearing Officer or Hearing Officer assigned to the matter finds good cause exists to stay the limitation, prohibition or suspension. New Rule 9558(g) provides the process by which a Member Organization subject to a suspension may request termination of the suspension. Last, the Exchange notes that the concept of allowing a Member or Member Organization the right to transact at Members' commission rates applied to the time when the Exchange had seats, and thus is no longer applicable.
- Rule 124 concerns disputes that occur on or relate to the Phlx options trading floor. Under subparagraph (b) of the Rule, a Member's, Member Organization's, or

Associated Person's failure to comply with an initial Options Exchange Official ruling may result in a referral to the BCC. Phlx is replacing reference to the BCC with reference to the Phlx Regulation Department, Department of Market Regulation, or Department of Enforcement, which will be charged with the review of any such referred non-compliance. Phlx is proposing that the Phlx Regulation Department, Department of Market Regulation, and Department of Enforcement have this discretion under the proposed Rules because these departments may exercise prosecutorial discretion to determine if formal disciplinary action is warranted. To the extent the Phlx Regulation Department, Department of Market Regulation, or Department of Enforcement determines that formal disciplinary action is warranted, the department must gain approval from the ODA to issue a complaint. As described above, the ODA is an office within FINRA, independent of the enforcement function and not involved in investigating or litigating cases. Thus, ultimately the referred non-compliance will be reviewed by a committee independent of the enforcement function. Phlx is also replacing references to Rules 60 and 970 in subparagraphs (b) and (c) of the rule with references to New Rules 9216(c) and (b), respectively, which have replaced those Rules as discussed both above and below. Phlx is also making it clear under Rule 124(c) that Options Exchange Official rulings issued pursuant to Floor Procedure Advices not related to Order and Decorum are subject to the 9000 Series. As described below in relation to Rule 970, Phlx is adopting the process used by BX and Nasdaq in administering their MRVPs.<sup>148</sup> Specifically, once the Phlx

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<sup>148</sup> New Rule 9216(b).

Regulation Department,<sup>149</sup> the Department of Enforcement or the Department of Market Regulation determine [sic] that a fine should be levied against a Member, Member Organization, or an Associated Person, a draft letter is provided to the Member, Member Organization, or Associated Person. If a Member, Member Organization, or Associated Person does not agree to the terms of a minor rule violation letter or violation letter proposed by the Exchange pursuant to the Advises, then it is not compelled to accept the letter. As a consequence, however, the Exchange or FINRA acting on its behalf may pursue formal disciplinary action. Phlx notes that assessing a fine pursuant to the Advises in lieu of pursuing formal disciplinary action is always discretionary. Thus, if a Member, Member Organization, or Associated Person does not agree to the terms of a minor rule violation plan letter or violation letter provided, then the matter may be resolved through the formal disciplinary process, through which the Member, Member Organization, or Associated Person may submit arguments in its defense through an Answer. Phlx is also replacing references to the Market Operations Review Committee in subparagraph (d) with references to the Exchange Review Council, which is the committee responsible for reviewing disputed rulings under the New Rules. Under subparagraph (d)(v) of the Rule, all decisions of the Market Operations Review Committee that are not complied with promptly by a Member, Member Organization, or Associated Person may result in referral to the BCC. Phlx is replacing reference to the BCC with reference to the Phlx Regulation Department, Department of Market Regulation, and Department of Enforcement, each of which

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<sup>149</sup> See notes 47 and 55, supra.

will have authority to review of any such referred non-compliance since each of these departments may exercise their prosecutorial discretion to determine if formal disciplinary action is warranted. To the extent the Phlx Regulation Department, Department of Market Regulation, or Department of Enforcement determines that formal disciplinary action is warranted, the department must gain approval from the ODA to issue a complaint pursuant to New Rule 9211(a)(1). As described above, the ODA is an office within FINRA, independent of the enforcement function and not involved in investigating or litigating cases. Thus, ultimately the referred non-compliance will be reviewed by a committee independent of the enforcement function.

- Rule 600 concerns a Member's and Member Organization's obligation to provide notice to the Exchange of its address and any changes thereto. The Rule also requires Members and Member Organizations to use FINRA's Web Central Registration Depository for reporting obligations. Rule 600(c) requires each Member and Member Organization applicant that is a registered broker or dealer pursuant to Section 15 of the Securities Exchange Act of 1934 must [sic] use Web CRD to submit a Uniform Application for Broker-Dealer Registration, Form BD. The Exchange is deleting the term "member" from Rule 600(c) because it erroneously applies the requirement to Members, which, as discussed above, cannot be registered brokers or dealers. The Exchange is also adopting a new paragraph (d) to the Rule, which requires Member Organizations to report all contact information required by the Exchange to the FINRA Contact System. FINRA uses the FINRA Contact System as the repository of member firm contact information for its members, as do BX and Nasdaq under their

- respective Rule 1160. The Exchange is adopting this requirement to facilitate FINRA's execution of its responsibilities under the RSA.
- Rule 615 concerns the Exchange's authority to waive the applicable Qualification Examination and accept other standards as evidence of an applicant's qualifications for registration. The Exchange is amending this Rule to make clear that the New Rule 9600 Series process for receiving a waiver is followed for such requests. The New Rule 9600 Series concerns the procedures for Member Organizations to request exemptions, and the appeal of adverse decisions regarding an exemptive request. Thus, Member Organizations may request an exemption to a Qualification Examination on behalf of their Associated Persons. The Exchange notes that text of Rule 615 currently closely mirrors BX and Nasdaq Rule 1070(d) and that the new language added to Rule 615 is taken from these BX and Nasdaq Rules.
  - Rule 712 concerns the Exchange's requirement that each Member Organization doing business with the public have an independent audit of its affairs at least once a year. Under the Supplementary Material to the Rule, the BCC provided guidance to Member Organizations on the textual requirements of the agreement between the Member Organization and its accountant, which is provided in supplementary material to the Rule and is cited as a directive of the BCC. In such references to the BCC, the Exchange is replacing it with references to the Exchange. With the retirement of the BCC, the Exchange is adopting the directive as a directive of the Exchange. The guidance requires accountants to Member Organizations to agree to provide notice of the commencement of an audit, and provide certain documents to the BCC. The Exchange is replacing references in the guidance to the BCC with

references to the Membership Department, which the Exchange has determined is the best entity within the Exchange to receive such notice and documents in the absence of the BCC. The purpose of the guidance is to ensure that the Exchange is notified of the initiation of the required annual audit, thus aiding the Exchange in its oversight responsibilities. Likewise, the documents required to be provided by the auditing accountant ensures [sic] that the Exchange is aware of any identified deficiencies. The Exchange is now requiring that accountants performing annual audits provide the notice discussed above to the Membership Department.

- Rule 722 concerns requirements for margin accounts in miscellaneous securities. Subparagraph (d) of the rule provides that the BCC may appoint a World Currency Options Margin Subcommittee, charged with the monitoring of the use of letters of credit by world currency option writers, monitoring the volatility of each world currency underlying a class of world currency options traded on the Exchange and for recommending to the Exchange that higher margin requirements be imposed with respect to any world currency option position(s) whenever such Subcommittee deems such higher margin requirements advisable. The Exchange is replacing references to the BCC and Subcommittee with reference to the CRO and Committee, respectively. The Exchange believes that the CRO is best suited to select members of such a committee to make these determinations in light of the retirement of the BCC because the CRO has general supervision of the Exchange's regulatory operations, including the responsibility for overseeing its surveillance, examination, and enforcement functions and for administering any regulatory services agreements with another self-regulatory organization to which the Exchange is a party. The CRO meets with the



regulatory oversight committee of the Board of Directors. As such, the Board will remain apprised of the formation of, and any decisions made by, the new Committee.

The Exchange notes that the new Committee will have the same responsibilities under the amended rule as the Subcommittee does currently.

- Rule 774 is currently held in reserve. The Exchange is amending Rule 774 to now include an express requirement that Member Organizations and Members not engage in disruptive quoting and trading activity. BX and Nasdaq adopted this authority under their respective Equities Rule 2170 and Options Rule Chapter III, Section 16 to clearly prohibit disruptive quoting and trading activity on both the equities and options markets.<sup>150</sup> BX and Nasdaq also adopted new Rules 9400 to permit them to take prompt action to suspend their members or their clients that violate such rule. The Exchange is amending Rule 774 to house the obligation of its Member Organizations and Members, which will apply to both participation in the Exchange's equity and options markets. The Exchange is amending Rule 3202 to include Rule 774 as a rule that applies to the Nasdaq PSX ("PSX") equities market. The Exchange

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<sup>150</sup> See Securities Exchange Act Release No. 77913 (May 25, 2016), 81 FR 35081 (June 1, 2016) (SR-NASDAQ-2016-074) (adopting the prohibition applied to the equity market and the disciplinary process) and Securities Exchange Act Release No. 77914 (May 25, 2016), 81 FR 35106 (June 1, 2016) (SR-BX-2016-028) (adopting the prohibition applied to the equity market and the disciplinary process); see also Securities Exchange Act Release No. 78208 (June 30, 2016), 81 FR 44366 (July 7, 2016) (SR-NASDAQ-2016-092) (extending the prohibition to the options market) and Securities Exchange Act Release No. 78107 (June 21, 2016), 81 FR 41619 (June 27, 2016) (SR-BX-2016-036) (extending the prohibition to the options market). Nasdaq and BX filed immediately effective rule changes to make a technical correction to their respective Rules 9400 to include reference to their respective Options Rules Chapter III, Section 16, which were inadvertently not updated when Nasdaq and BX extended the prohibition on engaging in disruptive quoting and trading activity their options markets. See Securities Exchange Act Release No. 79240 (November 4, 2016), 81 FR 79068 (November 10, 2016) (SR-NASDAQ-2016-146) and Securities Exchange Act Release No. 79241 (November 4, 2016), 81 FR 79534 (November 14, 2016) (SR-BX-2016-056).

notes that Rules 600 through 799 concern the regulation of Members and Member Organizations (including associated persons thereof), and their participation on both the Exchange's equity and options markets. The Exchange is likewise adopting New Rule 9400 as adopted by BX and Nasdaq except that the Exchange rule includes the Department of Enforcement and the Department of Market Regulation as potential parties to the matter. As discussed above, the Exchange believes that including these departments in proposed New Rule 9400 Series is appropriate because they may be involved in the initiation of such a matter for BX and Nasdaq currently. The Exchange is also adding FINRA to other parts of New Rule 9400 where it is appropriate to show that FINRA may be the entity that initiated an action under the rule.

- Rule 777 prohibits certain guarantees made by Member Organizations or persons employed by them. Subparagraph (a) of the rule prohibits a guarantee of payment of the debit balance, in a customer's account, to his employer or to any other creditor carrying such account, without the prior written consent of the BCC. The Exchange is replacing reference to the BCC with reference to the CRO, who Phlx believes is best suited to make such determinations in light of the elimination of the BCC.
- Rule 923 sets forth an applicant's right to appeal an adverse action with respect to a membership application, permit application, or other matter for which the Membership Department has responsibility. The Exchange is retaining this right under the Rule, but is replacing the current Board subcommittee appeals process with an Exchange Review Council appeals process with discretionary review by the Board based on the processes of BX and Nasdaq under their respective Rules 1016 and

1015. In adopting the new rule text under Rule 923, the Exchange is not copying the term “Applicant,” which is a defined term under BX and Nasdaq membership proceedings rules. The Exchange is rather using the term “applicant” as it is represented in current Rule 923, which applies to membership applications, permit applications, or other matters for which the Membership Department has responsibility.

- The Rule 960 series sets forth the Exchange’s current Disciplinary Rules. The Exchange is deleting the entire rule series<sup>151</sup> and replacing it with the New Rule 8000 and 9000 Series. Specifically:
  - Rule 960.1 concerns the jurisdiction of the Exchange in disciplinary matters.
    - Rule 960.1(a) defines who is subject to the disciplinary jurisdiction of the Exchange as any Member, Member Organization, or any partner, officer, director or person employed by or associated with any Member or Member Organization (the Respondent) who is alleged to have violated or aided and abetted a violation of the Act, rules and regulations thereunder, the By-Laws and rules of the Exchange or any interpretation thereof, and the rules, regulations, resolutions and stated policies of the Board or any committee of the Exchange. After notice and opportunity for a hearing, such a Respondent may be appropriately disciplined by expulsion, suspension, fine, censure, limitation or termination as to activities, functions, operations, or association with a Member or Member Organization, or any other fitting sanction in

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<sup>151</sup> As discussed below, the Exchange will retain a transitional rule book that will contain the Exchange’s rules as they are at the time of this filing, including the Rule 960 series. This transitional rule book will apply only to matters initiated prior to the operational date of the changes proposed herein.

accordance with the provisions of the disciplinary rules. The Exchange is moving this rule to New Rule 9110(d), which is not included in Rule 9110 of either BX or Nasdaq, but will preserve the Exchange's current jurisdiction under its rules.

- Rule 960.1(b) permits the Exchange to charge a supervisor with a violation of a rule within the disciplinary jurisdiction of the Exchange committed by an employee under his supervision or by the Member Organization with which he is associated, as though such violations were his own. Similarly, the rule permits the Exchange to charge a Member Organization with any violation within the disciplinary jurisdiction of the Exchange committed by its officers, directors, or employees or by a Member or Associated Person, as though such violation were its own. The Exchange is moving this rule to New Rule 9110(d), which is not included in Rule 9110 of either BX or Nasdaq, but will preserve the Exchange's current jurisdiction under its rules.
- Rule 960.1(c) extends the disciplinary jurisdiction of the Exchange to continue after the termination of a Member's permit or employment or association with the firm, or following deregistration of the Member from the Exchange. Staff must serve written notice to the former Member within one year of receipt by the Exchange of notice of such termination or deregistration that the Exchange is making inquiry into a matter or matters, which occurred prior to the termination or deregistration. The Exchange is moving this Rule to New Rule 9110(d), which is not included in Rule 9110 of either BX or Nasdaq but will preserve the Exchange's current jurisdiction under its rules.

- Rule 960.1, Interpretations and Policies .01 defines the term “person associated with a member” or “associated person of a member” as the same meaning as Section 3(a)(21) of the Act. The Exchange is retaining this definition by amending Rule 1(b), which currently defines “associated person” or “person associated with a member organization,” but is making a corrective change to the rule text by making it clear that the Rule applies to persons associated with a “member organization” instead of a “member.” As discussed above, there are no persons associated with a Member. Therefore, under amended Rule 1(b), the Exchange is noting that, for purposes of the Rule 8000 and 9000 Series, the terms “person associated with a member organization” or “associated person” have the same meaning as the terms “persons associated with a member” or “associated person of a member,” respectively, as provided in Section 3(a)(21) of the Act.
- Rule 960.1, Interpretations and Policies .02 notes that summary suspension or other action taken pursuant to Exchange By-Laws or rules, or Section 6(d)(3) of the Act is not deemed to be disciplinary action under the disciplinary rules. The Exchange is replacing this Rule with New Rule 9558, which concerns summary proceedings authorized by Section 6(d)(3) of the Act. Although not explicitly noted in the New Rule, action taken under the rule is not defined as disciplinary action, but rather summary action to impose limitation, prohibition or suspension on a Member, Member Organization, or Associated Person, pending the opportunity for a hearing.

- Rule 960.2 concerns the investigative process and authorization of complaints.

The Exchange is replacing this Rule with New Rules under the Rule 8000 and 9000 Series.

- Rule 960.2(a) requires that the Exchange investigate possible violations within its disciplinary jurisdiction upon instruction of the Board, BCC, or other Exchange official or upon receipt by the Exchange of a written accusation from a Member, Member Organization, or Associated Person, which specifies in reasonable detail the facts that are subject to the accusation. The Exchange is replacing this Rule with New Rule 8210, which sets forth staff's (including FINRA staff's) authority to examine and investigate potential violations of the Exchange rules.
- Rule 960.2(b) requires a Member, Member Organization, or Associated Person to cooperate with Exchange staff in the investigative process, and to not otherwise impede or delay an Exchange investigation into matters within its disciplinary jurisdiction. The Exchange is replacing this Rule with New Rule 8210, which specifically sets forth the Member's, Member Organization's, Associated Person's, or person subject to the Exchange's jurisdiction's obligation to cooperate with the Exchange and FINRA in the investigative process.
- Rule 960.2(c) sets forth a Member's, Member Organization's or Associated Person's right to counsel in connection with requests for information, documents or testimony and throughout the course of any disciplinary proceeding and the review thereof, or any hearing concerning a summary

action. The Exchange is replacing this Rule with New Rule 9141(b), which provides that a Member, Member Organization, or Associated Person may be represented in any proceeding by an attorney, so long as the attorney has not been barred pursuant to New Rules 9150 or 9280. Although not explicitly stated in the rules, as is the case for BX and Nasdaq, FINRA allows a member or person associated with a member to be represented by counsel in an investigation.<sup>152</sup>

- Rule 960.2(d) requires staff to, upon forming a reasonable basis that a violation with [sic] the disciplinary jurisdiction of the Exchange has occurred, submit a written report to the BCC that specifies the violations and the facts that gave rise to the violations. The Exchange is replacing this Rule with New Rule 9211(a)(1), which provides a process whereby staff may seek approval from the ODA to issue a complaint in a matter when staff believes that any Member, Member Organization, or Associated Person is violating or has violated any rule, regulation, or statutory provision, including the federal securities laws and the regulations thereunder, which the Exchange has jurisdiction to enforce.
- Rule 960.2(e) requires staff, prior to submitting its report pursuant to subparagraph (d), to provide notice to the person who is the subject of the report of the nature of the allegations and specific rule(s) and/or law(s) that appear to have been violated. Such notice must also state that report will be

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<sup>152</sup> See FINRA Regulatory Notice 09-17 (March 2009) (stating, “All FINRA investigations are non-public and confidential, and firms and individuals are entitled to be represented by counsel.”).

reviewed by the BCC. The subject of the report may submit a written statement to the BCC stating why no disciplinary action should be taken. Staff must provide the subject with access to any documents and other materials in the Exchange's investigative file that were furnished by the subject or his agents. This Rule describes the "Wells Notice" process and, although there is no explicit rule under the New Rule 8000 and 9000 Series that describes the Wells Notice process, FINRA uses this process in its disciplinary process.<sup>153</sup>

- Rule 960.2(f)(i) requires the BCC to direct staff to prepare a Statement of Charges when it appears that there is probable cause for finding a violation within the disciplinary jurisdiction of the Exchange. Should the BCC determine there is not such probable cause, or disciplinary action is not warranted, it shall inform staff and instruct them not to initiate action. In such a case, the BCC must document its basis for its determination in its meeting minutes. This process is generally subsumed in the ODA approval process noted under New Rule 9211(a)(1). Under the new process, however, a complaint is required only if a settlement is unable to be reached. Although not noted in New Rule 9211(a)(1), FINRA represented to the Exchange that the ODA memorializes in writing all decisions not to authorize a complaint or accept a settlement.
- Rule 960.2(f)(ii) permits the Exchange, in the case of violations determined based on an exception-based surveillance program, to aggregate individual

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Id.



violations of the Exchange order handling rules and consider such violations as a single offense only in accordance with the guidelines set forth in the Exchange's Numerical Criteria for Bringing Cases for Violations of Exchange Order Handling Rules. The Rule also provides that the Exchange may batch individual violations of Rule 1014(c)(i)(A) pertaining to quote spread parameters (and corresponding Options Floor Procedure Advice F-6). In the alternative, the Exchange may refer the matter to the Business Conduct Committee for possible disciplinary action when: (i) the Exchange determines that there exists a pattern or practice of violative conduct without exceptional circumstances, or (ii) any single instance of violative conduct without exceptional circumstances is deemed to be so egregious that referral to the Business Conduct Committee for possible disciplinary action is appropriate. The Exchange is proposing to move the language under Rule 960.2(f)(ii) to New Rule 9211(a)(1), which discusses the authorization of complaints, with minor changes. Specifically, the Exchange is replacing text concerning referring matters to the BCC with requesting authorization from the ODA, which is the appropriate body responsible for authorizing the issuance of a complaint for conduct arising from violations under the Advices. The Exchange is also replacing references to the "Exchange" with references to the Phlx Regulation Department, Department of Enforcement, or the Department of Market Regulation. The Exchange is also being more specific under the New Rules by noting that Phlx Regulation Department, Department

of Enforcement, or the Department of Market Regulation may seek authorization to take formal disciplinary action from the ODA.

- Rule 960.3 concerns the contents and required service of Statements of Charges. The Rule requires Statements of Charges to include the specific provisions within the Exchange’s disciplinary jurisdiction alleged to have been violated, the persons or organizations alleged to have committed each of the violations (the “Respondents”), and the specific acts that give rise to the alleged violations. New Rule 9212(a)(1) sets forth the required contents of a complaint. In this regard, the new requirements are substantially similar to the old rule. Specifically, both rules require the Exchange to name the specific provision(s) of the rules purported to have been violated by the respondent(s), and the specific conduct that gave rise to the alleged violations. In addition, Rule 960.3 provides a definition of the term “Respondents” as noted above, whereas New Rule 9212 does not; however, New Rule 9120(aa) provides a definition of the term “Respondents,” which is materially identical to the definition in Rule 960.3 and is designed to encompass the same entity in the process. Specifically, New Rule 9120(aa) defines “Respondent” as an Exchange Member, Member Organization or Associated Person against whom a complaint is issued in a disciplinary proceeding governed by the New Rule 9200 Series and in an appeal or review governed by the New Rule 9300 Series. Moreover, the definition notes that in a proceeding governed by the Rule 9800 Series, the term “Respondent” means an Exchange Member, Member Organization or Associated Person that has been served a notice initiating a cease and desist proceeding. Rule 960.3 also requires that a copy of

the Statement of Charges be served on each of the Respondents. The Exchange is replacing this Rule with New Rule 9130 Series, which concerns the service and filing of papers in a matter. New Rule 9131 specifically sets forth the process for service of complaints and documents initiating proceedings.

- Rule 960.4 concerns the content and timing of submission of an Answer to a Statement of Charges. The Rule requires a Respondent to file an Answer within 15 business days after service of the Statement of Charges. The Rule allows a Member, Member Organization, or Associated Person to request a hearing or alternatively request that a decision be rendered based upon the written submissions. The Rule also provides that the charges shall be considered admitted by a Member, Member Organization, or Associated Person that fails to submit an Answer within the specified time, or failed to receive an extension from Exchange staff prior to the expiration of the 15 business day deadline. The Exchange is generally replacing this Rule with rules found in the New Rule 9220 Series, which concern requests for hearings. New Rule 9215 concerns Answers to Complaints and requires Respondents to file an Answer within 25 days after service of a complaint. New Rule 9138(a) defines a “day,” for purposes of the New Rule 9000 Series, as a calendar day. Like the old Rule, New Rule 9269 provides for the issuance of a default decision against a Respondent that fails to answer the complaint within the time afforded under New Rule 9215. Under New Rule 9221, a Respondent may request [sic] hearing, and if it does not request a hearing, subparagraph (c) of the rule permits a Hearing Panel or Extended Hearing Panel to consider the matter on the record.

- Rule 960.5 concerns the hearings process, and sets forth, among other things, the process for requesting a hearing, how Hearings Panels are selected, and the roles and responsibilities of Hearing Panel members and counsel thereto, the pre-hearing and hearing procedures, and the conduct of hearings. The Exchange is replacing this Rule with the New Rule 9200 Series, which provides a more comprehensive process than the existing rule.
  - Rule 960.5(a)1. allows a hearing to be held on a Statement of Charges if requested by the Respondent in its Answer or upon motion of the BCC or staff. The Rule requires hearings to be presided over by three Hearing Panelists. New Rule 9221 provides a Respondent with the right to request a hearing in its answer. If a Respondent does not request a hearing in its answer and, in the absence of a waiver by an adjudicator for a hearing request submitted after submission of the answer, the decision may be made on the record, as defined in New Rule 9267. Pursuant to New Rule 9221(b), in the absence of a request for a hearing from any Respondent, the Hearing Officer may order any complaint set down for hearing. Pursuant to New Rule 9221(c), if all respondents waive a hearing, and the Hearing Officer does not order a hearing on his or her own motion, a Hearing Panel or, if applicable, the Extended Hearing Panel may order a hearing or may consider the matter on the record. Further, if fewer than all Respondents waive a hearing, a Hearing Officer, a Hearing Panel or, if applicable, an Extended Hearing Panel, may exercise its discretion to order that a hearing be held as to all Respondents or, alternatively, conduct a hearing as to only those Respondents

who requested a hearing and consider the matter on the record as to those Respondents who waived a hearing. Consequently, the new rule will preserve the ability for a Respondent to request a hearing, and for an adjudicator to order a hearing, however, staff will no longer have the authority to request a hearing. The Exchange notes that both the Hearing Officer and Hearing Panel may exercise discretion to order a hearing, thereby providing unbiased judgement on whether a hearing is warranted.

- Rule 960.5(a)2. requires that the Chair of the BCC or its designee name a Hearing Panel within ten business days of receipt of notice that the Respondent has requested a hearing, upon motion of the BCC for naming of a Hearing Panel, or upon Respondent's request that the matter be decided on written submissions. Under the Rule, the BCC Chair or its designee must promptly notify staff and the Respondent of the selection. New Rule 9213(a) provides that a Hearing Officer must be assigned to preside over the matter as soon as practicable after staff files a complaint, and requires that Parties are provided with notice of the Hearing Officer's assignment pursuant to New Rule 9132. New Rule 9213(b) provides that the Chief Hearing Officer must appoint Hearing Panelists pursuant to New Rules 9231 and 9232 as soon as practicable after assigning the Hearing Officer in the matter.
- Rule 960.5(a)3. sets forth the responsibilities of the Hearing Panel, which include but are not limited to presiding over hearings in contested disciplinary cases, conducting pre-hearing conferences, ruling on procedural or discovery matters, making all necessary evidentiary or other rulings, regulating the

conduct of a hearing, imposing appropriate sanctions for improper conduct by a party or a party's representative, issuing decisions, and rendering decisions in connection with Summary Disposition Proceedings. The Rule also prohibits Hearing Panelists from involvement with the investigative process, participation in the decision to institute disciplinary proceedings, issue decisions without a majority concurrence of the Hearing Panel, rule on requests to disqualify a member of the Hearing Panel, or issue citations for violations of Exchange Rules and Floor Procedure Advices. Hearing Panelists under the current Rule may be Members, general partners or officers of Member Organizations, or other individuals that the BCC Chair or its designee deems qualified. New Rule 9231(b) describes the compositional requirements of Hearing Panels. Under the New Rule, the Hearing Panel generally must consist of a Hearing Officer and two Hearing Panelists. The Chief Hearing Officer is responsible for selecting the Panelists, who must be associated with a Member Organization or retired therefrom. New Rule 9233(a) requires a Hearing Officer to recuse himself if he determines that he has a conflict of interest or bias or circumstances otherwise exist where his fairness might reasonably be questioned. Subparagraph (b) of the New Rule provides that a Party may move for the disqualification of a Hearing Officer. New Rule 9234(a) applies the same recusal standard as New Rule 9233(a) to Hearing Panelists. Likewise, New Rule 9234(b) provides parties with a process identical to New Rule 9233(b), yet also provides that the Chief Hearing Officer may order the disqualification of a Hearing Panelist if he

determines that the Panelist has a conflict of interest or bias or circumstances otherwise exist where his fairness might reasonably be questioned. New Rule 9231(b)(1) permits the Chief Hearing Officer to select as a Panelist a person who: (A) previously served on the Exchange Review Council; (B) previously served on a disciplinary subcommittee of the Exchange Review Council, including a Subcommittee, an Extended Proceeding Committee, or their predecessor subcommittees; (C) previously served as a Director, or as a Governor of the Exchange prior to its acquisition by Nasdaq, Inc., but does not serve currently in that position; or (D) is a FINRA Panelist approved by the Exchange Board at least annually, including a member of FINRA's Market Regulation Committee or who previously served on the Market Regulation Committee not earlier than four years before the date the complaint was served upon the Respondent who was the first served Respondent in the disciplinary proceeding for which the Hearing Panel or the Extended Hearing Panel is being appointed, or from other sources the Board deems appropriate given the responsibilities of Panelists. For purposes of initially applying New Rule 9231(b)(1)(B), the Exchange will allow former BCC members and former MORC members to serve as Panelist under the Rule. The Exchange believes that this is appropriate because it will be drawing from both of the groups for Exchange Review Council members.

- Rule 960.5(a)4. describes the role of the Hearing Attorney. The Hearing Attorney assists a Hearing Panel in the discharge of its duties. The Hearing Attorney advises the Hearing Panel on application of rules, sanctions and

relevant precedent, yet may not vote in the disposition of a matter. Under the existing Rule, the Hearing Attorney is subject to the same conflict of interest prohibitions as Hearing Panelists. Under the New Rules, hearings will be conducted by FINRA's OHO, which is responsible for the adjudication of matters. Hearings conducted by the OHO are managed by a Hearing Officer, who is an attorney appointed by the Chief Hearing Officer to act in an adjudicative role and fulfill various adjudicative responsibilities and duties set forth in the New Rule 9200, 9550, and 9800 Series (see New Rule 9120(r)). Hearing Officers are subject to the same conflicts of interest standard as a Hearing Panelist. This standard requires a Hearing Officer to withdraw from a matter any time he or she determines that he or she has a conflict of interest or bias or circumstances otherwise exist where his or her fairness might reasonably be questioned (see New Rule 9233(a)). Similarly, in appellate matters, the Exchange Review Council is assigned counsel. New Rule 9120(e) defines the term "Counsel to the Exchange Review Committee" as an attorney that reports to the Chief Regulatory Officer of the Exchange who is responsible for advising the Exchange Review Council, the Review Subcommittee, a Subcommittee, or an Extended Proceeding Committee regarding a disciplinary proceeding on appeal or review before the Exchange Review Council. Counsel also may decide a motion on a procedural matter in the Rule 9300 Series (see New Rule 9146(j)). New Rule 9313 describes the authority of the Counsel and the process for seeking the review of a Counsel decision. Under New Rule 9313(a), Counsel has authority to take ministerial



and administrative actions to further the efficient administration of a proceeding. A Party may seek review of a Counsel decision on motion to the Exchange Review Council, the Review Subcommittee, a Subcommittee or, if applicable, an Extended Proceeding Committee. Similar to the Hearing Attorney, Counsel is subject to the same conflict of interest prohibitions as the Exchange Review Council (see New Rule 9332), which requires that if a member of the Exchange Review Council, including a member of the Review Subcommittee, a Panelist of a Subcommittee or an Extended Proceeding Committee, or a Counsel to the Exchange Review Council determines that the member, the Panelist, or the Counsel to the Exchange Review Council has a conflict of interest or bias or circumstances otherwise exist where the fairness of the member, the Panelist, or the Counsel to the Exchange Review Council might reasonably be questioned, the member, the Panelist, or the Counsel to the Exchange Review Council shall notify the Chair of the Exchange Review Council, and the Chair of the Exchange Review Council shall issue and serve on the Parties a notice stating that the member, the Panelist, or the Counsel to the Exchange Review Council has withdrawn from the matter.

- Rule 960.5(a)5. requires written notice of the Hearing Panelist selection to be given to the Respondent. The Rule provides opportunity for any person involved in the disciplinary proceeding to disclose any relationship with a Hearing Panelist, which might result in such Panelist being unable to render a fair and impartial decision. New Rule 9233(b) permits a Party to move for the disqualification of a Hearing Officer not later than 15 days after the later of:

(1) when the Party learned of the facts believed to constitute the disqualification; or (2) when the Party was notified of the assignment of the Hearing Officer. Similarly, New Rule 9234(b) permits a Party to move for the disqualification of a Hearing Panelist within 15 days after the later of: (1) when the Party learned of the facts believed to constitute the disqualification; or (2) when the Party was notified of the assignment of the Hearing Panelist.

- Rule 960.5(a)6. outlines Hearing Panelist compensation, including additional compensation in extraordinary cases. Under New Rule 9231(c), the Chief Hearing Officer may determine based on the complexity of the issues involved, the probable length of the hearing, or other factors that the Chief Hearing Officer deems material, that a matter be designated as an Extended Hearing, and that such matter be considered by an Extended Hearing Panel. Similarly, under New Rule 9331(a)(2) the Exchange Review Council or Review Subcommittee may designate a matter as an Extended Proceeding and that such matter be considered by an Extended Proceeding Committee based upon consideration of the volume and complexity of the certified record, or other factors deemed material by the Exchange Review Council or Review Subcommittee. The primary significance of such a designation is to allow the compensation of Extended Hearing Panelists at the rate then in effect for arbitrators appointed under the FINRA Rule 12000 and 13000 Series.
- Rule 960.5(a)7. vests the BCC Chair with authority to appoint a qualified replacement Hearing Panelist should a Hearing Panelist become unavailable. New Rule 9231(e) provides that the Chief Hearing Officer may replace a

Hearing Officer if the Hearing Officer withdraws, is incapacitated, or otherwise is unable to continue service after being appointed. Similarly, New Rule 9234 provides the Chief Hearing Officer the authority to appoint new Hearing Panelists.

- Rule 960.5(b)1. requires a hearing on the Statement of Charges to be held no later than 120 days after the earlier of the filing date of the Answer or the date the BCC requests a hearing. The hearing date may be extended by Hearing Panel for good cause. New Rule 9221(d) provides that the Hearing Officer must issue a notice stating the date, time, and place of the hearing, and whether the hearing shall be held before a Hearing Panel or an Extended Hearing Panel, and shall serve such notice on the Parties at least 28 days before the hearing, unless: (1) in the discretion of the Hearing Officer, he or she determines that extraordinary circumstances require a shorter notice period; or (2) the Parties waive the notice period. Unlike Rule 960.5(b)1., New Rule 9221(d) does not impose a deadline by which a hearing must be held but the Exchange anticipates hearings will generally be held within 120 days.
- Rule 960.5(b)2. requires that the Respondent be given notice at least 15 business days before the hearing of the time and place of the hearing. As noted above, New Rule 9221(d) provides that notice of the hearing date and location must be provided to the Parties at least 28 days before the hearing.
- Rule 960.5(b)3. permits the Respondent or staff to request in writing an adjournment of the hearing date for just cause. The Hearing Panel must

promptly consider the request and inform the parties of its determination. If granted, the Hearing Attorney must also inform the parties of the new hearing date. New Rule 9222 concerns extensions of time, postponements, and adjournments. Under the New Rule, a Hearing Officer may, for good cause shown, change the place of the hearing, postpone the commencement of the hearing, or adjourn a convened hearing for a reasonable period of time. Such an extension may not exceed 28 days unless the Hearing Officer states on the record or provides by written order the reasons a longer period is necessary.

- Rule 960.5(b)4. requires parties to furnish to the Hearing Panelists and each other copies of all documentary evidence to be presented at the hearing, and a list of witnesses to be called at the hearing. New Rule 9261 provides that, no later than ten days before the hearing, or at such earlier date as may be specified by the Hearing Officer, each Party shall submit to all other Parties and to the Hearing Officer copies of documentary evidence and the names of the witnesses each Party intends to present at the hearing.
- Rule 960.5(b)5. permits the Hearing Panel to schedule pre-hearing conferences not less than eight business days prior to the hearing date. Pre-hearing conferences are held for the purpose of clarifying and simplifying issues and otherwise expediting the proceeding, and must be attended by all parties and the Hearing Panel. New Rule 9241 provides that, on his or her own motion or at the request of a Party, the Hearing Officer may, in his or her discretion, order counsel or any Party to meet for a pre-hearing conference. The conference may be held for the following non-exclusive list of reasons:

expediting the disposition of the proceeding; establishing procedures to manage the proceeding efficiently; and improving the quality of the hearing through more thorough preparation. Under the New Rule, an initial pre-hearing conference, unless determined by the Hearing Officer to be unnecessary or premature, shall be held within 21 days after filing of an Answer. Under New Rule 9241(f), a Hearing Officer may issue a default decision against a Party that fails to appear at a pre-hearing conference, if the Party was provided due notice.

- Rule 960.5(c) vests the Hearing Panelists with authority to determine all questions concerning the admissibility of evidence, and to otherwise regulate the conduct of the hearing. The Rule also states that the formal rules of evidence do not apply. The Rule requires staff to present the charges in the matter, and permits both parties to present evidence and produce witnesses that testify under oath and are subject to cross-examination. The Rule also allows the Hearing Panel to request production of documentary evidence and witnesses, and to question witnesses. Last, the Rule requires that a written transcript be made of the hearing, which becomes part of the record. New Rule 9263 provides the Hearing Officer with authority to receive relevant evidence, and to exclude all evidence that is irrelevant, immaterial, unduly repetitious, or unduly prejudicial. New Rule 9145(a) provides that the formal rules of evidence shall not apply in a proceeding brought under the Rule 9000 Series.

- Rule 960.5, Interpretation and Policy .01 permits a non-party to the matter to intervene upon showing that it has an interest in the subject of the hearing and that the disposition of the matter may impair or impede its ability to protect its interest. The Hearing Panel may also permit a non-party to intervene as a party when the person's claim or defense and main action have questions of law or fact in common. A non-party wishing to intervene must file with the Hearing Panel a notice requesting the right to intervene, stating the grounds therefor, and setting forth the claim or defense for which intervention is sought. The Exchange is eliminating the ability for a non-party to intervene, but will allow the consolidation of proceedings under New Rule 9214, which concerns consolidation and severance of disciplinary proceedings. Under subparagraph (b) of the New Rule, a Party may file a motion to consolidate two or more disciplinary proceedings if such consolidation would further the efficiency of the disciplinary process, or if the subject complaints involve common questions of law or fact or one or more of the same Respondents. When determining whether to order the consolidation of such disciplinary proceedings, the New Rule requires the Chief Hearing Officers to consider whether the same or similar evidence reasonably would be expected to be offered at each of the hearings, whether the proposed consolidation would conserve the time and resources of the parties, and whether any unfair prejudice would be suffered by one or more parties as a result of the consolidation. Unlike Rule 960.5, Interpretation and Policy .01, New Rule 9214 does not permit a non-party to a disciplinary proceeding to file a motion

or intervene in the proceeding in any manner whatsoever. The Exchange believes that eliminating the ability of a non-party to intervene in a matter is a better practice and will ensure that disciplinary proceedings are limited to issues of concern to parties of a matter while still allowing the consolidation of matters under the conditions noted above.

- Rule 960.5, Interpretation and Policy .02 requires a Hearing Panel to consider whether the intervention will unduly delay or prejudice the adjudication of the rights of the original parties. As noted above, the New Rules do not permit a non-party to a disciplinary proceeding to file a motion or intervene in the proceeding in any manner whatsoever. Also as noted above, New Rule 9214(a) permits the Chief Hearing Officer to consolidate disciplinary proceedings after considering, among other things, whether any unfair prejudice would be suffered by one or more parties as a result of the consolidation.
- Rule 960.5, Interpretation and Policy .03 prohibits any person not otherwise a party or licensed counsel representing a party from attending a hearing unless specifically allowed by the Hearing Panel. The new rules do not have a provision specifically concerning attendance at a hearing; however, hearings will be similarly limited to parties and licensed counsel. New Rule 9141(b) concerns who may represent a Party in a matter. The New Rule provides that a licensed attorney may represent a Party in a proceeding, a member of a partnership may represent the partnership, and a bona fide officer of a corporation, trust or association may represent the corporation, trust or

association. New Rule 9261(a) requires Parties to submit to all other Parties and to the Hearing Officer copies of documentary evidence and the names of the witnesses each Party intends to present at the hearing.

- Rule 960.6 concerns the summary disposition process. Under Rule 960.6(a), a Hearing Panel may issue a summary decision in a disciplinary proceeding that violations within the disciplinary jurisdiction of the Exchange have occurred and impose sanctions upon those culpable for such conduct if the Respondent has admitted to the violation(s), or there is no dispute concerning those material facts which give rise to such violation(s). Under Rule 960.6(b), the Exchange is required to serve the summary decision on the Respondent(s), to which the Respondent(s) may reply with a request to set aside any of the findings made or sanctions imposed by the summary decision. Rule 960.6(b) also provides that the Respondent(s) may request a hearing in their [sic] reply, which is governed by Rule 960.5 and, in cases where the Respondent has admitted to committing a violation, any further proceedings are limited to the issue of the propriety of the sanction imposed. Rule 960.6(c) requires the Hearing Panel to set aside a decision in a summary proceeding if the Respondent establishes that an issue of material fact or law exists as to any of the finding [sic] contained or sanctions imposed in the summary decision. New Rule 9264 provides for summary disposition. Unlike Rule 960.6, a motion for summary disposition must be initiated by a Party. Moreover, New Rule 9264 has different requirements based on when in the process the motion is made. Under the New Rule, the Respondent and/or staff may, prior to the Hearing but after the Respondent has filed an answer



and had opportunity to inspect documents in the record, make a motion for summary disposition of any or all the causes of action in the complaint with respect to that Respondent, as well as any defense raised in a Respondent's answer. If a hearing on the merits has begun, then parties may submit such a motion only with leave of the Hearing Officer. New Rule 9264(c) provides the process for proceeding when a summary motion does not dispose of the matter entirely. Under the New Rule, the Hearing Panel must, if practicable, ascertain what material facts exist without substantial controversy and what facts are controverted, and, based on this determination, issue an order specifying such. New Rule 9264(d) requires motions for summary disposition to be supported by a statement of undisputed facts, a supporting memorandum of points and authorities, and affidavits or declarations that set forth such facts. Because summary disposition proceedings are initiated by the Hearing Panel under Rule 960.6, there is no such analogue under the New Rules. New Rule 9264(e) concerns rulings on motions for summary disposition. The New Rule provides that a Hearing Officer may deny or defer a decision on any motion for summary disposition, yet only a Hearing Panel or, if applicable, the Extended Hearing Panel, may grant such a motion, except that the Hearing Officer may grant motions for summary disposition with respect to questions of jurisdiction. The New Rule also provides that a motion for summary disposition may be granted if there is no genuine issue with regard to any material fact and the Party that files the motion is entitled to summary disposition as a matter of law.

- Rule 960.7 concerns offers of settlement. Under the Rule, a Respondent in a matter may submit an offer of settlement within 120 days of submitting its Answer. The offer of settlement must contain a proposed stipulation of facts and shall consent to specified sanctions. The BCC may accept the offer of settlement or reject it. Should the BCC reject the offer of settlement, the matter will proceed normally. As noted above, in certain cases FINRA will negotiate a settlement prior to the issuance of a complaint. In such cases, the proposed Statement of Charges and offer of settlement are provided to the BCC for review and approval, with the BCC treating the offer of settlement as the Respondent's Answer. The Exchange is replacing this Rule with New Rule 9270,<sup>154</sup> which provides expressly that a Respondent to [sic] propose in writing an offer of settlement at any time. The offer must conform to the requirements of the New Rule and in submitting the offer the Respondent waives certain rights. If the Phlx Regulation Department,<sup>155</sup> Department of Enforcement or Department of Market Regulation do [sic] not oppose the offer of settlement, it is considered uncontested. Similar to Rule 960.7, an uncontested offer of settlement is provided to the Exchange Review Council (or to the ODA, in the case of a Respondent that is an affiliate of

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<sup>154</sup> As discussed above, the Exchange is also adopting an acceptance, waiver and consent process under New Rule 9216(a), which allows for the settlement of matters prior to the issuance of a complaint. The Exchange is proposing to include the Phlx Regulation Department as an entity that may administer the acceptance, waiver and consent process under New Rule 9216(a) in addition to the Department of Enforcement and Department of Market Regulation, which is unlike the analogous rules of BX and Nasdaq that reference only the Department of Enforcement and Department of Market Regulation.

<sup>155</sup> The Exchange is proposing to include the Phlx Regulation Department as an entity that may administer the settlement process under New Rule 9270(e) in addition to the Department of Enforcement and Department of Market Regulation, which is unlike the analogous rules of BX and Nasdaq that reference only the Department of Enforcement and Department of Market Regulation.

the Exchange within the meaning of Rule 985) by the Phlx Regulation Department, Department of Enforcement or Department of Market Regulation together with its recommendation. Under New Rule 9270(e), the ODA or Review Subcommittee may also accept any uncontested offer of settlement, and the Review Subcommittee may reject uncontested offers of settlement while the ODA may only reject uncontested offers of settlement involving Respondents that are affiliates of the Exchange. If a hearing on the merits has begun, the offer of settlement and a proposed order of acceptance is provided to the Hearing Panel or, if applicable, the Extended Hearing Panel for acceptance or rejection. If accepted by the Hearing Panel or, if applicable, the Extended Hearing Panel, the offer of settlement and the order of acceptance shall be forwarded to the Exchange Review Council (or to the ODA, in the case of a Respondent that is an affiliate of the Exchange within the meaning of Rule 985) to accept or reject. As described above, the Review Subcommittee may accept or reject an uncontested offer of settlement, and the ODA may only accept an uncontested offer of settlement not involving an Exchange affiliate.

- Rule 960.7 Interpretation and Policies .01 allows the BCC to consider an offer of settlement submitted after 120 days as long as its consideration does not delay the hearing in the matter. The policy also provides that, if the Respondent submits an offer of settlement after the hearing has commenced, staff must promptly submit its position with respect to the offer and the Hearing Panel will then determine whether to consider the offer, and if so, determine whether to accept or reject the offer. The Exchange is replacing this policy with New Rule 9270(a), which

provides that if a Respondent proposes an offer of settlement after the hearing on the merits has begun, the making of an offer of settlement shall not stay the proceeding, unless otherwise decided by the Hearing Panel or, if applicable, the Extended Hearing Panel. Under New Rule 9270(e), if an offer of settlement is offered after a hearing has commenced and it is uncontested, then the Phlx Regulation Department, the Department of Enforcement or Department of Market Regulation must transmit the offer with a proposed order of acceptance to the Hearing Panel or, if applicable, the Extended Hearing Panel, for approval or rejection. Under New Rule 9270(f), which concerns contested offers of settlement provided prior to or after a hearing has commenced, if an offer of settlement is offered after a hearing has commenced and it is contested then the Phlx Regulation Department, the Department of Enforcement or the Department of Market Regulation must provide a written opposition to the Hearing Panel or, if applicable, the Extended Hearing Panel, which may issue an approval or rejection of the offer, or may order the Parties [sic] attend a settlement conference. If a contested offer of settlement is approved by the Hearing Panel, or, if applicable, the Extended Hearing Panel, the Hearing Officer shall draft an order of acceptance of the offer of settlement, which is sent to the Exchange Review Council (or ODA in the case of a Respondent that is an Exchange affiliate) for acceptance or rejection. The Review Subcommittee may accept or reject a contested offer of settlement and offer [sic] of acceptance, other than those concerning a Respondent that is an Exchange affiliate, or refer them to the Exchange Review Council.

- Rule 960.8 concerns the content, approval and issuance of Hearing Panel decisions. The Rule requires the Hearing Panel to review the entire record and make a determination by a majority vote on the disposition of the matter, including whether a Respondent committed violations and the appropriate sanctions, if any. The Rule requires the Hearing Panel to thereafter issue a written decision consistent with its determination. The written decision must contain a statement of findings and conclusions, with the reasons therefor, upon all material issues presented in the record, and whether each violation within the disciplinary jurisdiction of the Exchange alleged in the Statement of Charges occurred. The Rule requires the Hearing Panel, absent extraordinary circumstances, to issue its decision within 60 days after its receipt of the Transcript from staff, a copy of which must be promptly served on the Respondent. Last, the Rule requires disciplinary sanctions arising from the decision be made public in a manner prescribed by the Board of Directors. The Exchange is replacing this Rule with New Rule 9268, which concerns decisions of Hearing Panels or, if applicable, the Extended Hearing Panel. Similar to the old Rule, the New Rule requires the Hearing Panel to make a determination in a matter based on a majority vote, which is reflected in a decision drafted by the Hearing Officer. Also similar to the old Rule, New Rule 9268 requires a decision to include, in part, the specific statutory or rule provisions allegedly violated, a statement that sets forth the findings of the Hearing Panel with respect to the act or practice the Respondent was alleged to have committed or omitted, and to provide the conclusions of the Hearing Panel whether the Respondent violated any provision alleged in the

complaint. The New Rule requires that the decision be issued within 60 days of the final date allowed for filing proposed findings of fact, conclusions of law, and post hearing briefs, or by a date established by the Chief Hearing Officer.

Although the date on which the 60 day period begins is different between the old and New Rules, the principle is the same, namely that once the matter is closed to further motion or argument a decision must be issued within the required timeframe. Last, under subparagraph (d) of the New Rule, the OHO must publish notice of the decision and any dissenting opinion in the Central Registration Depository and provide a copy of the decision and any dissent thereto to the each Member Organization of the Exchange with which the Respondent is associated.

- Rule 960.8, Supplementary Material, provides the Board of Directors' directive with regard to publicity of sanctions. The Exchange is replacing this Rule with New Rule IM-8310-3, which concerns the release of disciplinary complaints, decisions, and other information. The New Rule generally requires the Phlx Regulation Department to release information concerning a decision that imposes a suspension, bar, cancellation or expulsion of a Member Organization or Member; suspension or revocation of a Member's permit; or suspension, bar or revocation of the registration of a Member or Associated Person. Unlike BX and Nasdaq Rules 8310(a), New Rule 8310(a) will include suspension of a Member's permit and revocation or cancellation of a Member's permit as available sanctions under the rule, which is consistent with the authority currently provided under Rule 960.10(a)(1). As described above, BX and Nasdaq do not have Associated Persons that are permit holders, and therefore Members. Consequently, the

Exchange is including Members in IM-8310-1, which discusses the effect of a suspension, revocation, cancellation or bar. The Exchange is also including disclosure of suspension of a Member's permit and revocation or cancellation of a Member's permit under New Rule IM-8310-3. The Regulation Department may also release such information concerning a decision where there is a significant policy or enforcement determination and the CRO has deemed the release to be in the public interest.

- Rule 960.9 concerns the review process of Hearing Panel decisions, which includes both appeals thereof and the initiation of reviews by the Board of Directors.
  - Rule 960.9(a) provides a Respondent ten days after service of the notice and decision to appeal the decision to the Board of Directors by service of the petition on the Secretary of the Exchange. The Rule requires the petition to be in writing and to specify the findings and conclusions of the decision, which is the subject of the petition, together with the reasons that the Respondent petitions for review of these findings. Any objections to a decision not specified in the petition are thereafter waived. The rule permits staff to provide a written response to the request filed with the Secretary within fifteen days of service of the petition. Under the rule, staff may request review of a decision by petitioning the Board of Directors within ten days after the decision. The New Rule 9300 series concerns the review of Disciplinary Proceedings by the Exchange Review Council, Board of Directors, and CRO. Under the new process, a Hearing Panel decision issued pursuant to New

Rules 9268 (Decision of Hearing Panel) or 9269 (Default Decisions) may be appealed to the Exchange Review Council by a party within 25 days after service of a decision . See New Rule 9311(a). A Hearing Panel decision issued pursuant to New Rule 9268 may be called for review by the Exchange Review Council within 45 days after the date of service of the decision. See New Rule 9312(a)(1). A Hearing Panel decision issued pursuant to New Rule 9269 may be called for review by the CRO within 25 days after the date of service of the decision. Should the matter move forward (i.e., the appeal is not withdrawn, abandoned, or the call for review is withdrawn), the Exchange Review Council will issue its own decision. Under the New Rule 9350 series, a Director of the Board of Directors may call for review of the decision of the Exchange Review Council not later than the next meeting of the Board of Directors that is at least fifteen days after the date on which the Board of Directors receives the Exchange Review Council decision. Unlike the old rule, New Rule 9351(a) does not provide a right to Parties to petition the Board of Directors for a review of an Exchange Review Council decision. The Exchange believes this is appropriate because parties are given the right to appeal a Hearing Panel decision to the Exchange Review Council, which serves in a similar appellate capacity as the Board of Directors under the old process.

- Rule 960.9(b)(i) concerns the Hearing Panel decision review process. Under the rule, the review is conducted by the Board of Directors or an Advisory Committee thereof. If an Advisory Committee is appointed, it must be



composed of three Board Directors, one of which must be a Public Director appointed by the Chair of the Board. Any Board member that participated in the matter before the BCC or Hearing Panel may not participate in the Board review. Last, the rule provides that a matter is considered on the record and written exceptions filed by the parties, unless the adjudicators determine to hear oral arguments. As noted above, the Exchange Review Council performs a similar appellate function as the Board of Directors under the old process. Under New Rule 9332, Exchange Review Council members are subject to the same disqualification and recusal standards as the Hearing Panelists and Hearing Officers, including a direct conflict of interest such as prior participation in the matter. Under the new Exchange Review Council process and pursuant to New Rule 9331(b), a Subcommittee or Extended Proceeding Committee is formed for the purpose of participating in a hearing, to the extent oral arguments are heard, and to recommend the disposition of a matter before the Exchange Review Council. New Rule 9343 provides that, if no oral argument is held, a matter shall be decided on the record, supplemented by any written materials submitted to or issued by the Subcommittee or, if applicable, the Extended Proceeding Committee, or the Exchange Review Council in connection with the appeal, cross-appeal, or call for review. Pursuant to New Rule 9346, the Exchange Review Council is charged with issuing a decision based on the record, as described above, and any oral argument permitted under the Code of Procedure, subject to limited exception.

- Rule 960.9(b)(ii) concerns reviews conducted by the Board of Directors. Under the rule, the Board must determine, by a majority vote, whether to affirm, reverse or modify, in whole or in part the decision of the Hearing Panel. The Board may not reverse or modify, in whole or in part the decision of the Hearing Panel if the factual conclusions in the decision are supported by substantial evidence and the decision is not arbitrary, capricious or an abuse of discretion. The rule requires the Board decision to be in writing and promptly served on the Respondent. Last, the rule provides that the Board decision represents the final disciplinary sanction of the Exchange in terms of the Act. As noted above, the Exchange Review Council performs a similar appellate function as the Board of Directors under the old process. Under New Rule 9348, the Exchange Review Council may affirm, dismiss, modify, or reverse with respect to each finding, or remand the proceeding with instructions. The Exchange Review Council may also affirm, modify, reverse, increase, or reduce any sanction, or impose any other fitting sanction. The Exchange Review Council must issue a decision consistent with New Rule 9349(b), which provides elements required to be included in an Exchange Review Council decision.
- Rule 960.9(b)(iii) concerns reviews conducted by an Advisory Committee of the Board. The Advisory Committee must submit a report to the Board with a recommendation to affirm, reverse or modify, in whole or in part, the decision of the Hearing Panel. A modification may include an increase or decrease of the sanction. Like the Board process, the Advisory Committee may not

reverse or modify, in whole or in part the decision of the Hearing Panel if the factual conclusions in the decision are supported by substantial evidence and the decision is not arbitrary, capricious or an abuse of discretion. The Board must determine to affirm, reject or modify, in whole or in part the recommendation of the Advisory Committee under the same standard as if were reviewing the matter itself. The rule requires the Board decision to be in writing and promptly served on the Respondent. Last, the rule provides that the Board decision represents the final disciplinary sanction of the Exchange in terms of the Act. The Advisory Committee process is similar to the compulsory Subcommittee or Extended Proceeding Committee process under the New Rule 9330 series, as discussed above.

- Rule 960.9(c) permits the Board to initiate a review of a Hearing Panel decision within twenty days of Respondent's notice of the decision. A review initiated under this rule follows the process outlined above. As noted above, the Exchange Review Council performs a similar appellate function as the Board of Directors under the old process. Under New Rule 9312(a), the Exchange Review Council may call for review of the decision of a Hearing Panel within forty-five days after the date of service of the decision. If, however, the Hearing Panel decision relates to a default decision issued pursuant to New Rule 9269, the Chief Regulatory Officer may call such decision for review within twenty-five days after the date of service of the decision. If called for review, such decision will be reviewed by the Exchange Review Council. As discussed, under the new process, an

Exchange Review Council decision may be reviewed by the Board of Directors pursuant to New Rule 9351, and any final Exchange action may be appealed to the Commission pursuant to New Rule 9370.

- Rule 960.9(d) permits a Respondent to request review of a decision in a disciplinary proceeding to the Board in writing within ten days after the decision has been rendered. An appeal taken by staff or by a Respondent will be determined on the written record; however, parties may request an oral argument before the Board or Advisory Committee. As noted above, the Exchange Review Council performs a similar appellate function as the Board of Directors under the old process. Under New Rule 9311(a), a Respondent or the Phlx Regulation Department, the Department of Enforcement or the Department of Market Regulation may file written notice of appeal within twenty-five days after service of a decision.
- Rule 960.9(e) provides the process for staff to request Board review of a Hearing Panel decision, the timing of which mirrors that of a Respondent's appeal to the Board. As noted above, the Exchange Review Council performs a similar appellate function as the Board of Directors under the old process. Under New Rule 9311(a), a Respondent or the Phlx Regulation Department, the Department of Enforcement or the Department of Market Regulation may file written notice of appeal within twenty-five days after service of a decision.

- Rule 960.10 concerns the process for determining appropriate sanctions against Members, Member Organizations, or persons associated with Member Organizations and the effectiveness of judgments.
  - Rule 960.10(a)(1) requires Members, Member Organizations, or persons associated with Member Organizations to be appropriately disciplined for violations under the disciplinary rules by expulsion, suspension, fine, censure, limitations or termination as to activities, functions, operations, or association with a Member Organization, or any other fitting sanction. The Exchange is replacing this rule with New Rule 8310(a), which stands for the same proposition that Members, Member Organizations, and persons associated with Member Organizations should be subject to appropriate sanction for each violation of the federal securities laws, rules or regulations thereunder, subject to the process under the New Rule 9000 Series. Unlike BX and Nasdaq Rules 8310(a), New Rule 8310(a) will include suspension of a Member’s permit and revocation or cancellation of a Member’s permit as available sanctions under the rule, which is consistent with the authority currently provided under Rule 960.10(a)(1). As described above, BX and Nasdaq do not have Associated Persons that are permit holders, and therefore Members.
  - Rule 960.10(a)(2) requires the BCC and Hearing Panel to refer to the Exchange’s “Enforcement Sanctions User’s Guide” when imposing sanctions for violation of the Order Handling Rules. Under New Rule 9270(c)(5), the Enforcement Sanctions User’s Guide must be considered in settlement

proceedings involving all proceedings under the New Rule 9000 Series. The Exchange notes that this is consistent with analogous rules of BX and Nasdaq.

- Rule 960.10(b) provides that sanctions imposed under the disciplinary rules are not effective until the Exchange review process is completed or the decision otherwise becomes final. Pending effectiveness of a decision imposing sanctions on a Respondent, a Hearing Panel may impose conditions and restrictions on the activities of a Respondent which it finds to be necessary or appropriate for the protection of the investing public, Members, Member Organizations, and persons associated with Member Organizations, and the Exchange and its subsidiaries. Under the new rules, the concept of final exchange action for purposes of Rule 19d-1(c)(1) of the Act is reflected in multiple sections of the rule. Generally, action in a matter is not final until all periods available for appeal of a decision or call for review have lapsed. Under New Rule 9268(e), a Hearing Panel decision becomes final action if it is not appealed timely pursuant New Rule 9311 or timely called for review by the Exchange Review Council pursuant to New Rule 9312. New Rule 9268(e) provides that a majority decision of a Hearing Panel with respect to a Member or Member Organization that is an affiliate of the Exchange within the meaning of Rule 985(b) is final action of the Exchange and cannot be appealed or called for review. New Rule 9269 concerns default decisions in a matter before a Hearing Panel. Subparagraph (d)(1) provides that the default decision becomes final action if it is not appealed timely pursuant New Rule 9311 or timely called for review by the Exchange Review Council pursuant to

New Rule 9312. New Rule 9269(d)(2), a default decision with respect to an Exchange member or member organization that is an affiliate of the Exchange within the meaning of Rule 985(b) constitutes final disciplinary action of the Exchange and cannot be appealed or called for review. New Rule 9349(c) concerns final exchange action with respect to an Exchange Review Council decision. Under the rule, the decision of the Exchange Review Council becomes final action of the Exchange after the decision has been provided to the Board of Directors and the decision was not called for review pursuant to New Rule 9351. If the Exchange Review Council decision remands the matter to the Hearing Panel, however, the decision is not final exchange action and will continue through the Code of Procedure process. If the Board of Directors calls an Exchange Review Council decision for review, any decision issued by the Board of Directors become final exchange action, unless the decision remands the matter, in which case the matter continues through the Code of Procedure process. The New Rule 9800 Series concerns temporary cease-and-desist orders, and provides the process by which the Phlx Regulation Department, the Department of Enforcement or the Department of Market Regulation may impose such restrictions and how such restrictions are adjudicated.

- Rule 960.11 concerns the requirements for service of notice under the disciplinary rules and the authority of the BCC, Hearing Panel or other appropriate committee to provide extensions to certain time limits under the Disciplinary Rules.

- Rule 960.11(a) permits any charges, notices or other documents to be served on the Respondent or its counsel, either personally or by deposit in the U.S. mail, either registered or certified, or by courier. Such service must be made to the Respondent or its counsel at the address as it appears on the books and records of the Exchange, or by e-mail by the written mutual consent of the parties. The rule also requires that all documents required by the disciplinary rules filed by any party to also be filed with the Hearing Panel and all parties, and received on the day prescribed by the disciplinary rules. The Exchange is replacing this rule with the New Rule 9130 Series, which concerns service and filing of papers. The new rule series provides the timing and form of required service based on the type of the notice. New Rule 9134 concerns the methods of and procedures for service. Like the old rule, New Rule 9134 permits personal service, service by U.S. Postal Service, or service by courier.
- Rule 960.11(b) permits the BCC or its designee, Hearing Panel, or the appropriate committee before whom a matter is pending, to extend any time limit imposed under the disciplinary rules, unless otherwise noted. The Exchange is replacing this rule with New Rules 9222 and 9322. New Rule 9322(a) allows, any time prior to the issuance of a decision, the Exchange Review Council, the Review Subcommittee, a Subcommittee or, if applicable, an Extended Proceeding Committee, or Counsel to the Exchange Review Council, for good cause shown, to extend or shorten a period prescribed by the Code for the filing of any papers, except that Counsel to the Exchange Review Council may shorten a period so prescribed only with the consent of



the Parties. Similarly, New Rule 9322(b) allows the Exchange Review Council, the Review Subcommittee, a Subcommittee or, if applicable, an Extended Proceeding Committee, or Counsel to the Exchange Review Council, for good cause shown, to postpone, adjourn, or change the location of the oral argument, except that Counsel to the Exchange Review Council may adjourn or adjourn the oral argument only with the consent of the Parties. New Rule 9222(a) allows, at any time prior to the issuance of the decision of the Hearing Panel or, if applicable, the Extended Hearing Panel, the Hearing Officer to, for good cause shown, extend or shorten any time limits prescribed by the Code for the filing of any papers and, consistent with paragraph (b), postpone or adjourn any hearing. Paragraph (b) requires the Hearing Officer to take into consideration several factors in determining to grant an extension and limits the length of the extension to 28 days unless the Hearing Officer states on the record or provides by written order the reasons a longer period is necessary.

- Rule 960.12 concerns fairness and impartiality of Board or Committee members in the disciplinary process. The rule sets forth the impartiality standard for adjudicators and provides the process for the removal of an adjudicator that does not meet the standard, either by motion of the chair or the adjudicator.
  - Rule 960.12(a) prohibits a Board or Committee member, Hearing Officer, or Hearing Panelist from participating in any disciplinary proceeding if the individual cannot render a fair and impartial decision in the matter. In such a case, the rule requires the individual to remove himself from any

consideration of the matter. As discussed above, New Rule 9233(a) requires a Hearing Officer to recuse himself if he determines that he has a conflict of interest or bias or circumstances otherwise exist where his fairness might reasonably be questioned. New Rule 9234(a) applies the same recusal standard as New Rule 9233(a) to Hearing Panelists. Similarly, New Rule 9332(a) requires an Exchange Review Council member and Counsel to recuse themselves should they determine that he has [sic] a conflict of interest or bias or circumstances otherwise exist where the fairness of the Exchange Review Council member or Counsel might be reasonably questioned.

- Rule 960.12(b) provides the Chair of an adjudicatory body authority to remove an individual from consideration of a matter, upon receiving written notice that such individual cannot render a fair and impartial decision in the disciplinary proceeding. The written notice must specify the grounds for contesting the qualification of the individual. The determination of the Chair is final and conclusive with respect to the participation of the individual. The Exchange is replacing this rule with New Rules 9233(b), 9234(b) and 9332(b). New Rule 9233(b) provides that a party may move for the disqualification of a Hearing Officer. Likewise, New Rule 9234(b) provides parties with a process identical to New Rule 9233(b), yet also provides that the Chief Hearing Officer may order the disqualification a Hearing Panelist if he determines that he has a conflict of interest or bias or circumstances otherwise exist where his fairness might reasonably be questioned. New Rule 9332(b) provides that a party may move for the disqualification of an Exchange Review Council

member, Review Subcommittee [sic], a Panelist of a Subcommittee or an Extended Proceeding Committee, or Counsel to the Exchange Review Council.

- Rule 970 provides the process for assessing fines not relating to Order and Decorum up to \$10,000 in lieu of formal disciplinary proceedings. The Exchange is replacing Rule 970 with New Rule 9216(b).
  - Rule 970(a) sets forth the Exchange's authority to assess a fine no greater than \$10,000 on a Member, Member Organization, or Associated Person in lieu of any disciplinary proceeding, other than regulations relating to order, decorum, health, safety and welfare on the Exchange pursuant to Section H of the Option Floor Procedure Advices. The rule also provides that any fines assessed pursuant to this Rule not exceeding \$2,500, and non-contested are not publicly reported to the Members except as may be required by Rule 19d-1 under the Exchange Act, or any other regulatory authority. The rule notes that any fine imposed pursuant to this Rule which exceeds \$2,500 shall be publicly reported to the Members as required by Rule 19d-1 under the Securities Exchange Act of 1934, and as may be required by any other regulatory authority. The Exchange is replacing Rule 970(a) with New Rules 9216(b)(1) and (2), which provides the Exchange's authority to assess such fines, and with New Rule 9216(b)(1)(D) and New Rule 9216(b)(2)(D).
  - Rule 970(b) sets forth the notice requirements for service upon the Member, Member Organization, or Associated Person against which the fine is levied. The Exchange is replacing this rule with New Rule 9216(b)(1)(A), which describes the

required contents of a minor rule violation plan letter, and New Rule 9216(b)(2)(A), which describes the required contents of a violation letter.

- Rule 970(c) states that payment of a fine assessed under the rule is deemed a waiver of a right to a disciplinary proceeding. The Exchange is replacing this rule with New Rules 9216(b)(1)(A), 9216(b)(2)(A), 9216(b)(1)(B), and 9216(b)(2)(B). New Rules 9216(b)(1)(A) and 9216(b)(2)(A) note that the Member, Member Organization, or Associated Person waives any right to hearing or appeal. New Rules 9216(b)(1)(B)(i)(a) and 9216(b)(2)(B)(i)(a) provide additional waivers not noted in Rule 970(c), concerning claims of bias or prejudice of the CRO or Exchange Review Council in such body's participation in discussions of the terms and conditions of the minor rule violation plan letter or violation letter. New Rules 9216(b)(1)(B)(i)(b) and 9216(b)(2)(B)(i)(b) provide additional waivers not noted under Rule 970(c) concerning ex parte communications. All of these new waivers arising from a Member's, Member Organization's or Associated Person's execution of a minor rule violation plan letter or a violation letter are a result of the different process for issuing fines for Advices. Under the current rule, a Member, Member Organization, or Associated Person may contest a citation by filing an Answer, which is provided to the BCC for disposition. Under the New Rules, a minor rule violation plan letter or a violation letter, as applicable, is agreed upon between the Exchange, or FINRA on its behalf, and the Member, Member Organization, or Associated Person. The waivers under New Rules 9216(b)(1)(A), 9216(b)(2)(A), 9216(b)(1)(B), and 9216(b)(2)(B) serve to protect the parties involved in the negotiated disposition of a matter through a minor rule

violation plan letter or violation letter. Should a Member, Member Organization, or Associated Person not consent to the issuance of a minor rule violation plan letter or violation letter, the matter may be subject to formal disciplinary action, as is the current practice for contested matters under Rule 970(d).

- Rule 970(d) sets forth the process a Member, Member Organization, or Associated Person must follow to contest the assessment of a fine assessed under the rule. As noted immediately above, the new process requires that a minor rule violation plan letter, or violation letter, is agreed upon prior to its issuance. As a consequence, there is no provision under the new rules for contesting a fine. If a Member, Member Organization, or Associated Person does not agree to the terms of a minor rule violation plan or violation letter proposed by the Exchange, then it is not compelled to accept the letter.
- Rule 970(e) sets forth the review process of a contested fine. Under the rule, the BCC may then: (a) decide that the matter be dismissed and the notice of alleged violation be rescinded; (b) decide that the notice, as issued, is valid, whereupon the alleged violator could either pay the fine or contest the matter before a Hearing Panel; (c) decide that the notice, as issued, should be modified to specify either a higher or lower fine than the one on the notice as issued, whereupon the alleged violator could either pay the new fine or contest the matter before a Hearing Panel; or (d) decide that the matter merits formal disciplinary action and authorize issuance of a complaint, pursuant to Rule 960.2. As noted above, should a Member, Member Organization, or Associated Person not consent to the terms of a proposed minor rule violation plan letter or a violation letter, the matter

may be subject to formal disciplinary proceedings. Unlike a hearing under Rule 970(d), the Exchange, or FINRA acting on its behalf, may pursue formal disciplinary action in any matter wherein a Member, Member Organization, or Associated Person refuses to consent to a minor rule violation plan letter or violation letter. As a consequence, there is no discretion to rescind, affirm or modify a determination prior to initiation of a formal disciplinary proceeding.

- Rule 970(f) sets forth the possible outcomes arising from a disciplinary proceeding arising from a contested fine. The rule provides that a hearing panel may impose any disciplinary sanction provided for in Disciplinary Rules, and may determine whether the violation is minor in nature. The rule further provides that if the violation is determined to be minor in nature, the violation(s) giving rise to the penalty shall not be publicly reported, except as may be required pursuant to Rule 19d-1 of the Exchange Act, or as may be required by any other regulatory authority. The rule notes that if the violation is determined to not be minor in nature, the decision of the Hearing Panel and any penalty imposed shall be publicly reported to the Members, Member Organizations, and persons associated with Member Organizations, in addition to any filing required by Rule 19d-1 of the Exchange Act, or any other regulatory authority, once such decision becomes “final” under the Disciplinary Rules. As noted above, the new process requires that the terms of a minor rule violation plan letter or a violation letter are agreed upon prior to their issuance. As a consequence, there is no provision under the new rules for contesting a fine. If a Member, Member Organization, or Associated Person does not agree to the terms of a minor rule violation letter or a

violation letter proposed by the Exchange, then it is not compelled to accept the letter. Should a Member, Member Organization, or Associated Person not consent to the terms of a proposed minor rule violation plan letter or violation letter, the matter is subject to formal disciplinary action, as is the current practice for contested matters under Rule 970(d). As discussed above, under the new rules, if a Member, Member Organization, or Associated Person does not agree to the terms of a proposed minor rule violation plan letter or violation letter, the Exchange or FINRA acting on its behalf will pursue a formal disciplinary proceeding against the Member, Member Organization, or Associated Person.

- Rule 970, Commentary .01 permits the Exchange to “batch” individual violations of order handling Options Floor Procedure Advices that are based on an exception-based surveillance program. The rule provides that such batch violations may be treated as a single occurrence, only in accordance with the guidelines set forth in the Exchange’s Numerical Criteria for Bringing Cases for Violations of Phlx Order Handling Rules. The rule further provides that the Exchange may batch individual violations of Rule 1014(c)(i)(A) pertaining to quote spread parameters (and corresponding Options Floor Procedure Advice F-6). The Exchange may, in the alternative, refer the matter to the Business Conduct Committee for possible disciplinary action when (i) the Exchange determines that there exists a pattern or practice of violative conduct without exceptional circumstances, or (ii) any single instance of violative conduct without exceptional circumstances is deemed to be so egregious that referral to the Business Conduct Committee for possible disciplinary action is appropriate. The

Exchange is proposing to move Commentary .01 to New Rules 9216(b)(1)(E) and 9216(b)(2)(E) with minor changes. Specifically, the Exchange is replacing text concerning referring matters to the BCC with requesting authorization from the ODA, which is the appropriate body responsible for authorizing the issuance of a complaint for conduct arising from violations under the Advises. The Exchange is also replacing references to the “Exchange” with references to the Phlx Regulation Department, Department of Enforcement, or the Department of Market Regulation. The Exchange is also being more specific under the New Rules by noting that Phlx Regulation Department, Department of Enforcement, or the Department of Market Regulation may seek authorization to take formal disciplinary action from the ODA.

- Rule 985 sets forth the limitations on ownership of the Exchange’s parent company Nasdaq and restrictions on the Exchange’s affiliation with Members, Member Organizations, and persons associated with Member Organizations. Rule 985(b) is cited in several sections of the New Rule 9000 Series, which uses its definition of “affiliate” to draw distinctions in the appeals process. Rule 985 is based on BX Rule 2140. The term “member” under BX’s rules is synonymous with the Exchange’s definition of “member organization,” whereas the definition of a “member” of the Exchange relates to the permit holder.<sup>156</sup> BX does not have such a concept, nor does Nasdaq under its analogous rules. Given that the purpose of the rule is to guard against any possibility that the Exchange may exercise, or forebear to exercise, regulatory authority with respect to an affiliated member in a manner that is

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<sup>156</sup> See supra note 3.



influenced by commercial considerations, to provide an opportunity for Commission review of certain proposed affiliations, and to ensure that certain affiliated members do not receive advantaged access to information in comparison with unaffiliated members, the Exchange is adding to the rule references to Member Organizations.<sup>157</sup> When the rule was adopted, the Exchange neglected to include Member Organizations in the rule.<sup>158</sup> The Exchange is also clarifying in Rule 985(a)(i) that the rule applies to persons “associated with a member organization,” not “associated with a member.” As discussed above, there is no category of “person associated with a member” permitted by the Exchange, and thus the term “organization” was erroneously omitted when adopted.<sup>159</sup>

- Rule 1092 concerns obvious errors and catastrophic errors. The rule currently references the MORC as the body responsible for review of determinations made by Options Exchange Officials pursuant to the rule. In light of the fact that the MORC’s responsibilities are now incorporated into those of the Exchange Review Council, the Exchange is changing references to the MORC under the rule to references to the Exchange Review Council, which BX and Nasdaq have done in their analogous Options Rules Chapter V, Section 6(1).
- Rule 3202 concerns the application of other rules of the Exchange to the PSX equities market. The Exchange is amending references in this rule to replace references to the Rule 960 series with references to the New Rule 8000 and 9000 Series, delete

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<sup>157</sup> See Securities Exchange Act Release No. 58179 (July 17, 2008), 73 FR 42874 (July 28, 2008) (SR-Phlx-2008-31).

<sup>158</sup> Id.

<sup>159</sup> Id.

references to Rule 50, which is replaced by New Rule 9553, and make conforming updates to the titles of Rules 98, 705, 754, 756, 792, 794, 795, 797, 798, 803, 902, 903, 904, 905, 906, and 907. The Exchange is also adding Rule 774 to the list of rules applicable to PSX, which, as discussed above, is being adopted as an express requirement that Member Organizations and Members not engage in disruptive quoting and trading activity. Last, the Exchange is deleting reference to Rules 70, 71, 72, 73, 74, 75, and 76, which are being deleted as part of this proposal.

- Rule 3219 concerns the withdrawal of quotations in PSX. The Exchange is replacing reference to the MORC with reference to the Exchange Review Council under Subparagraph (f) of the rule, which concerns jurisdiction over proceedings brought by PSX Market Makers seeking review of the denial of an excused withdrawal pursuant to the rule, or the conditions imposed on their reentry.
- Rule 3220 concerns the voluntary termination of registration. The Exchange is replacing reference to the MORC with reference to the Exchange Review Council under Subparagraph (e) of the rule, which concerns jurisdiction over proceedings brought by market makers seeking review of their denial of a reinstatement pursuant to paragraphs (b) or (d) of the rule.
- Rule 3312 concerns clearly erroneous transactions. The Exchange is replacing several references to the MORC with references to the Exchange Review Council under Subparagraphs (c), (d)(1), (e)(2) and (f) of the rule. Subparagraph (c) of the rule concerns the review of clearly erroneous determinations. Subparagraph (d)(1) of the rule concerns the requirements for communicating materials to the Exchange.

- Subparagraph (e)(2) of the rule concerns fees for appeals. Lastly, Subparagraph (f) of the rule concerns refusal to abide by rulings of an Exchange official or the MORC.
- The Exchange’s Equity Floor Procedure Advices provide fine-based sanctions for violations of the Exchange’s regulations relating to equities trading. The Advices include MRVP violations, consistent with Rule 19d-1(c) under the Act.<sup>160</sup> Under the various fine schedules of these regulations, the fine amount increases with each additional violation of the particular advice violated. Upon reaching a certain number of violations of a particular advice over a certain period (as noted in the schedule), further sanction is discretionary with the BCC. In light of the retirement of the BCC, the Exchange is providing the Phlx Regulation Department, Department of Enforcement, and the Department of Market Regulation with discretionary authority to assess further sanction [sic] upon Members, Member Organizations or persons associated with a Member Organization for such violations of the Advices.<sup>161</sup> The Exchange believes that these departments are best positioned to make determinations of whether further sanction is warranted under the Advices or whether formal disciplinary action should be pursued for such repeated violations because it is the same prosecutorial discretion that these departments exercise in determining whether matters under investigation warrant formal disciplinary action. As a consequence, Phlx is replacing references in the regulations to the BCC with the Phlx Regulation Department, Department of Enforcement, and the Department of Market Regulation.

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<sup>160</sup> 17 CFR 240.19d-1(c).

<sup>161</sup> Notwithstanding, determinations to issue a fine are made on a case by case basis, whereby the Exchange considers the individual facts and circumstances to determine whether a fine of more or less than the recommended amount is appropriate for the violation, or whether the violation requires formal disciplinary action.

- The Exchange is also deleting certain references in the Equity Floor Procedure Advices that reference Members as being broker-dealers and/or having the obligations of a broker-dealer, or as having associated persons. As described above, Members may not be broker-dealers on the Exchange, and thus would not have such obligations or associated persons.
- The Exchange is also amending its Option Floor Procedure Advices and Order & Decorum Regulations, which provide fine-based sanctions for violations of the Exchange's regulations relating to options trading. These regulations include violations of the Exchange's MRVP relating to options trading. Under the various fine schedules of these regulations, the fine amount increases with each additional violation of the particular advice violated. Upon reaching a certain number of violation [sic] of a particular advice over a certain period (as noted in the schedule) further sanction is discretionary with the BCC. In light of the retirement of the BCC, the Exchange is providing the Phlx Regulation Department, Department of Enforcement, and the Department of Market Regulation with discretionary authority to assess further sanction [sic] upon Members, Member Organizations or persons associated with a Member Organization for such violations of the Advices, other than Order and Decorum Regulations, and to serve as the body to which certain violations are referred.<sup>162</sup> As noted above, the Exchange believes that these departments are

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<sup>162</sup> For example, Option Floor Procedure Advice B-6 provides, in part, that "In any instance where an order is misrepresented in this fashion due to factors which give rise to the concern that it was the result of anything other than an inadvertent error, the Exchange may determine to bypass the fine schedule below and refer the incident to the Business Conduct Committee for possible disciplinary proceedings in accordance with those procedures set forth under the Exchange's Disciplinary Rule 960." The Exchange is replacing the Business Conduct Committee with the Phlx Regulation Department,

best positioned to make determinations of whether further sanction is warranted under the Advices or whether formal disciplinary action should be pursued for such repeated violations because it is the same prosecutorial discretion that these departments exercise in determining whether matters under investigation warrant formal disciplinary action.<sup>163</sup> As a consequence, Phlx is replacing references in the Advices to the BCC with the Phlx Regulation Department, Department of Enforcement, and the Department of Market Regulation.<sup>164</sup> For Order and Decorum Regulations, the Exchange is proposing to provide only the Phlx Regulation Department with discretionary authority to assess further sanction upon Members, Member Organizations or persons associated with a Member Organization for such violations. The Exchange notes that, by definition, such violations arise from the trading floor, which the Phlx Regulation Department is best positioned to determine what the appropriate sanction is for repeated violation of these regulations in light of its physical presence on the trading floor. In addition, the Exchange is replacing certain references to the MORC with references to the Exchange Review Council, since the MORC's responsibilities are subsumed into those of the Exchange Review Council, as discussed above. The Exchange is also deleting certain text in the Advices that reference persons associated with Members or otherwise make it unclear

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Department of Enforcement, and the Department of Market Regulation, and is also replacing reference to the Disciplinary Rule 960 with reference to the New Rule 8000 and 9000 Series.

<sup>163</sup> As noted above, determinations to issue a fine are made on a case by case basis. See supra note 161.

<sup>164</sup> In Options Floor Procedure Advice F-11, the Exchange is replacing the uppercase word "Discretionary" with a lowercase word and is deleting the word "the" to conform the Advice with other Advices.

as to whether the rule applies to an associated person of a Member, which as described above does not exist.<sup>165</sup> The Exchange is also replacing references the [sic] “members” with references to “member organization” in Advices concerning obligations of registered broker-dealers.<sup>166</sup> The Exchange is updating rule citations in the Advices to reflect the appropriate rules in the New Rules. Last, the Exchange is deleting the upper case term “Member Organization” and is replacing it with the lower case term “member organization,” which is the convention used throughout the rules.

## **Conclusion**

The changes proposed herein will allow the Exchange to harmonize its investigatory and disciplinary processes with the processes of BX and Nasdaq, thus providing a uniform process for the investigation and discipline of members and persons associated with members across all three self-regulatory organizations as administered by FINRA pursuant to RSAs. Harmonizing the investigatory and disciplinary processes of all three self-regulatory organizations will bring efficiency to FINRA’s administration of its responsibilities under the RSAs because the process [sic] it must follow are nearly identical, and are all based on the process that FINRA itself follows. Harmonized processes will bring consistency to investigations and adjudications of rule violations, and will reduce the number of disciplinary processes and requirements with which Members, Member Organizations, and Associated Persons, as well as their counsel, must be familiar.

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<sup>165</sup> For example, in Options Floor Procedure Advice C-9 the Exchange is making it clear that the rule concerns persons on the floor associated with a member organization.

<sup>166</sup> The Exchange is also making a clarifying change to Options Advice F-23 “Clerks in the Crowd” to make it clear that a clerk is an Associated Person, and that the rule is referring to Member Organizations and not Members in describing the entity unable to effect transactions on the trading floor.

The Exchange believes that the new investigatory and disciplinary processes are substantially similar to the existing process, and where there are differences between the new and old processes, the Exchange believes that the new process does not disadvantage its Members, Member Organizations or Associated Persons. To the contrary, the Exchange believes that the new process will benefit all parties as it provides greater detail and specificity than the retired rules, and consequently is more transparent. Moreover, the Exchange notes that nearly two thirds of Phlx Member Organizations are also members of FINRA. Thus, those firms are already familiar with the FINRA disciplinary process.

The Exchange intends to announce the operative date of the new rules at least 30 days in advance via a regulatory alert. To facilitate an orderly transition from the current rules to the new rules, the Exchange is proposing to apply the current rules to all matters that the BCC has reviewed prior to the operative date. In terms of formal disciplinary matters, any matter that has been approved for the issuance of a Statement of Charges by the BCC will continue under the existing rules. In terms of applying the Advices, any fine that is subject to review by the BCC, but has not yet been reviewed by the BCC to determine whether to exercise its discretion to apply a fine or authorize disciplinary action as of the operative date, will instead be reviewed by the Phlx Regulation Department, Department of Market Regulation, or Department of Enforcement. Any fine that was imposed prior to the operative date that is contested will continue under the existing rules. As a consequence of this transition process, the Exchange will retain the BCC and the existing processes during the transition period until such time that there are no longer any matters proceeding under the current rules. To facilitate this transition process, the Exchange will retain a transitional rule book that will contain the Exchange's rules as they are at the time of that this proposal is [sic] filed with the Commission, including the Rule 960

series. This transitional rule book will apply only to matters initiated prior to the operational date of the changes proposed herein and it will be posted to the Exchange's public rules website. When the transition is complete and there are no longer any member organizations or persons subject to the Rule 960 series, the Exchange will remove the transitional rule book from its public rules website.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>167</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>168</sup> in particular, in that it is 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, and are [sic] not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

The Exchange also believes that the proposed rule is consistent with Section 6(b)(6) of the Act,<sup>169</sup> which requires the rules of an exchange provide that its members be appropriately disciplined for violations of the Act as well as the rules and regulations thereunder, or the rules of the Exchange, by expulsion, suspension, limitation of activities, functions, and operations, fine, censure, being suspended or barred from being associated with a member, or any other fitting sanction.

The Exchange believes that the proposed changes are consistent with these requirements because the changes harmonize Phlx's investigative and adjudicatory processes with similar processes used by BX and Nasdaq. The new processes are well-established as fair and designed

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<sup>167</sup> 15 U.S.C. 78f(b).

<sup>168</sup> 15 U.S.C. 78f(b)(5).

<sup>169</sup> 15 U.S.C. 78f(b)(6).



to protect investors and the public interest, providing greater detail and transparency in the processes than is currently provided under the Rule 960 Series. Because the Exchange is adopting these Rules materially unchanged from the related BX and Nasdaq rules, with only minor differences based on the need to account for the Exchange's trading floor and the Phlx Regulation Department's involvement in matters, the Exchange believes that the proposed changes should facilitate prompt, appropriate, and effective discipline of Members, Member Organizations, and Associated Persons consistent with the Act. The proposed rule change also makes miscellaneous changes to Exchange rules to account for the adoption of the New Rule 8000 and 9000 Series, and to make minor updates and corrections to the Exchange's rules.

Moreover, the Exchange believes that harmonizing the investigative and adjudicatory processes with those of BX and Nasdaq will reduce the burden on Members, Member Organizations, and Associated Persons that are also members or member organizations of BX, Nasdaq, and/or FINRA as they only will need to be familiar with a single process going forward. As discussed above, the new process will benefit all parties as it provides greater detail and specificity than the retired Rules and, consequently, is more transparent.

The Exchange also believes that adopting an Exchange Review Council is consistent with the Act because the committee's mandate is to, among other things, ensure consistent and fair application of the Exchange rules pertaining to discipline of Members, Member Organizations and Associated Persons. The Exchange Review Council will be a body appointed by the Exchange Board of Directors and composed of representatives of the securities industry as well as persons from outside the securities industry. The broad membership of the new Exchange Review Council will ensure that the decisions and guidance it provides will be fair and balanced. The Exchange Review Council will be similar in structure and function to the Review Councils

of BX and Nasdaq, as well as FINRA's National Adjudicatory Council. In addition to reviewing appeals of disciplinary actions, the Exchange Review Council will also have jurisdiction to review decisions to deny applications for membership in the Exchange, and appeals regarding limitations placed on members or their employees that are subject to a statutory disqualification. Additionally, the Exchange Review Council may consider and make recommendations to the Board on policy and rule changes relating to business and sales practices of Exchange Members, Member Organizations and Associated Persons, and enforcement policies, including policies with respect to fines and other sanctions. Thus, the Exchange Review Council will provide the Exchange and market participants with a fair and impartial body overseeing disciplinary matters, as well as the rules and policies concerning the disciplinary process. Last, the Exchange notes that Exchange Review Council will have significant overlap in membership with the current BCC, thereby ensuring familiarity with Exchange rules and membership issues. For these reasons, the Exchange believes that adoption of the Exchange Review Council is consistent with the Act.

The Exchange also believes that incorporating the functions of the MORC into the Exchange Review Council is consistent with the requirements of the Act because it will bring efficiency to the committee process, by vesting a single Board committee with responsibilities that would otherwise be spread across the MORC and proposed Exchange Review Council, while ensuring that such responsibilities are performed to a high regulatory standard. In this regard, the Exchange Review Council is, by every measure, a more diverse body than the MORC that it replaces, yet it will maintain overlapping membership with current MORC members. The broad membership of the new Exchange Review Council will ensure that decisions made with respect to the MORC's former responsibilities are made fairly. Maintaining overlap in

membership will ensure continuity and familiarity with the MORC responsibility and processes. In terms of similarity between the compositional requirements of the two committees, the Exchange notes that the proposed Exchange Review Council will have the same MORC requirement that not more than 50 percent of the committee's members be engaged in market making activity or employed by Exchange member organization whose revenues from market making exceed 10 percent of its total revenues.<sup>170</sup> The Exchange notes that the proposed By-Laws will limit Exchange Review Council members to a maximum of two consecutive three-year terms unlike the MORC, which has no stated limit in the By-Laws.<sup>171</sup> This requirement ensures that there is a consistent influx of new members to the Exchange Review Council. The proposed By-Laws further require that membership of the Exchange Review Council to [sic] be divided into three classes of members, whose terms expire in different years, thus ensuring that the Review Council is not completely reconstituted in any given year.<sup>172</sup> Accordingly, the Exchange believes that the proposed changes will serve to protect the public interest and promote appropriate discipline of members for violations of securities laws and rules of the Exchange. The Exchange notes that both BX and Nasdaq incorporated their respective MORCs into their Review Councils, making the same changes proposed herein.<sup>173</sup> Moreover, members of the MORC will be included in the membership of the Exchange Review Council. Thus, the change will not impose any burden on Members, Member Organizations, and Associated Persons, while

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<sup>170</sup> See Phlx By-Law, Article V, Section 5-3(d) and New Phlx By-Law, Article V, Section 5-3(b)(ii).

<sup>171</sup> See Phlx By-Law, Article V, Section 5-3(d) and New Phlx By-Law, Article V, Section 5-3(b)(iv). Note that under New Phlx By-Law, Article V, Section 5-3(b)(iv), an Exchange Review Council member may serve greater than two terms if the member is appointed to fill a term of less than one year, in which case the member may serve up to two consecutive three-year terms following the expiration of such member's initial term.

<sup>172</sup> See New Phlx By-Law, Article V, Section 5-3(b)(iv).

<sup>173</sup> See supra note 95.

reducing the burdens and inefficiencies experienced by the Exchange in managing multiple committees.

The Exchange believes that eliminating the BCC is consistent with Sections 6(b)(5) and 6(b)(6) of the Act,<sup>174</sup> because the Exchange is replacing the BCC with other groups and processes that, while different, will continue to provide Members, Member Organizations and Associated Persons with a fair investigative and adjudicatory process. In particular, the functions of the BCC will be handled by the ODA, Phlx Regulation Department, Department of Market Regulation, or Department of Enforcement, and the Exchange's CRO. The ODA will authorize the issuance of complaints, which is currently the responsibility of the BCC. The Phlx Regulation Department, Department of Market Regulation, or Department of Enforcement will each individually have the authority to assess, and determine the amount of, fines under the Advices after repeated violations thereof, with the exception of the Advices relating to Order and Decorum for which the Phlx Regulation Department will be solely responsible for assessing and determining the amount of fines thereunder. Although, the BCC currently is responsible for this, the Exchange notes that it believes that these departments are best positioned to make determinations of whether further sanction is warranted under the Advices or whether formal disciplinary action should be pursued for such repeated violations because it is the same prosecutorial discretion that these departments exercise in determining whether matters under investigation warrant formal disciplinary action. As described above, the ODA will review any such recommendation for formal disciplinary action. As described above, the CRO will have responsibility for the current BCC functions of approving of customer account guarantees and appointing of World Currency Options Margin committees, which do not fall within the ODA's

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<sup>174</sup> 15 U.S.C. 78f(b)(5) and (6).

purview. The Exchange believes that the CRO is best suited to manage these responsibilities. The Exchange notes that the CRO has general supervisory responsibility over the Exchange's regulatory operations, including the responsibility for overseeing its surveillance, examination, and enforcement functions and for administering any regulatory services agreements with another self-regulatory organization to which the Exchange is a party. The CRO meets with the regulatory oversight committee of the Board of Directors. As such, the Board will remain apprised of the formation of, and any regulatory decisions made by, the CRO, and any World Currency Options Margin Committee. In sum, each BCC function will be handled in a fair manner and provide Members, Member Organizations and Associated Persons with a well-known process.

The Exchange believes that its proposal furthers the objectives of Section 6(b)(7) of the Act,<sup>175</sup> in that it is designed to provide a fair procedure for the disciplining of members and persons associated with members, the denial of membership to any person seeking membership therein, the barring of any person from becoming associated with a member thereof, and the prohibition or limitation by the exchange of any person with respect to access to services offered by the exchange or a member thereof. Specifically, the Exchange believes that the proposed investigatory and disciplinary process is consistent with Section 6(b)(7) of the Act<sup>176</sup> because it is based on the existing processes used by BX and Nasdaq. The process is well-established as consistent with the Act and where there are differences from the processes used by BX and Nasdaq, such as accounting for conduct on the Exchange's floor, the Exchange has proposed a fair process that includes elements of existing Exchange processes and processes of BX and Nasdaq. For example, the Exchange is proposing to vest the Phlx Regulation Department,

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<sup>175</sup> 15 U.S.C. 78f(b)(7).

<sup>176</sup> Id.

Department of Enforcement, and the Department of Market Regulation with the authority to determine whether repeated violations of the Advises warrant additional fines or formal disciplinary proceedings, which is currently vested with the BCC. Notwithstanding, the Exchange will continue to make determinations to issue a fine on a case by case basis, whereby the Exchange considers the individual facts and circumstances to determine whether a fine of more or less than the recommended amount is appropriate for the violation, or whether the violation requires formal disciplinary action. Although the Exchange is replacing the BCC, which is independent of the investigatory and disciplinary processes, with the Phlx Regulation Department, Department of Enforcement, and the Department of Market Regulation, which are not, the Exchange believes that this will provide a fair procedure because these departments must gain approval to issue a complaint and [sic] settlements generally from the ODA, an entity independent of the enforcement function, if they determine formal disciplinary action is appropriate in lieu of a fine under the Advises. Moreover, if these departments determine that an additional fine is appropriate in lieu of pursuing formal disciplinary action, the departments are constrained by the maximum fine allowed under the Advises, which is the same constraint that the BCC has to the extent it determines an addition [sic] fine is appropriate.<sup>177</sup> If these departments instead determine that formal disciplinary action is warranted, they must gain approval to issue a complaint from the ODA, as discussed above.

Last, the Exchange believes that its proposal to phase-in the implementation of the new disciplinary process is consistent with Section 6(b)(7)<sup>178</sup> of the Act because both the current and proposed disciplinary processes are consistent with the Act, providing fair procedures for

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<sup>177</sup> As described above, the Exchange may assess fines up to \$10,000 under the Advises in lieu of pursuing formal disciplinary proceedings.

<sup>178</sup> Supra note 175.

disciplining Members, Member Organizations and Associated Persons. The Exchange is proposing to provide advanced notice of the implementation date of the new process, and will apply the new process to new matters that are initiated on or after that implementation date. Any matters initiated prior to the implementation date will be completed using the current process. As a consequence, the Exchange will delete the Rule 960 series from the rule book, but maintain a transitional rule book on the Exchange's public rules website (<http://nasdaqphlx.cchwallstreet.com/>), which will contain the Exchange rules as they are at the time of filing this rule change.<sup>179</sup> These transitional rules will apply exclusively to the matters initiated prior to the implementation date. Upon conclusion of the last matter to which the transitional rules apply, the Exchange will remove the defunct transitional rules from its public rules website. Thus, the transition will be conducted in a fair, orderly and transparent manner.

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

The Exchange does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended. The proposed rule change is not intended to address competitive issues, but it should reduce burdens on Members, Member Organizations, and Associated Persons. Specifically and as described in detail above, the Exchange believes that this change will bring efficiency and consistency in application of the investigative and adjudicatory processes, thereby reducing the burden on Members, Member Organizations, and Associated Persons who are also members of BX and/or Nasdaq.

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<sup>179</sup> The posting of the transitional rules on the public rules website will make it clear what disciplinary proceedings are governed by the transitional rules (i.e., matters initiated prior to the implementation date).

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

No written comments were either solicited or received.

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

Because the foregoing 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 from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>180</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>181</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is: (i) necessary or appropriate in the public interest; (ii) for the protection of investors; or (iii) otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule change should be approved or disapproved.

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:

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<sup>180</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>181</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.



Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-Phlx-2017-92 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-Phlx-2017-92. 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 website (<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 website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change.

Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to

make available publicly. All submissions should refer to File Number SR-Phlx-2017-92 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.<sup>182</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>182</sup> 17 CFR 200.30-3(a)(12).