

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-60687; File No. SR-Phlx-2009-59)

September 18, 2009

Self-Regulatory Organizations; NASDAQ OMX PHLX, Inc.; Order Approving Proposed Rule Change, as Modified by Amendment Nos. 1 and 2 Thereto, Relating to the Exchange's By-Laws, Regulatory Oversight Committee and Referee Program

On July 27, 2009, NASDAQ OMX PHLX, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change to modify its governance structure. On July 30, 2009, the Exchange filed Amendment No. 1 to the proposed rule change. The proposed rule change was published for comment in the Federal Register on August 11, 2009.³ On September 9, 2009, the Exchange filed Amendment No. 2 to the proposed rule change.⁴ The Commission received no comments regarding the proposal. This order approves the proposed rule change, as modified by Amendment Nos. 1 and 2.

I. Description of the Proposed Rule Change

The Exchange seeks to conform several aspects of its governance structure more closely to the governance structure of certain of its affiliates, The NASDAQ Stock Market LLC (the "NASDAQ Exchange") and NASDAQ OMX BX, Inc. ("BX").

Specifically, Phlx proposes to amend its By-Laws to allow for the elimination of its audit

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 60431 (August 4, 2009), 74 FR 40265 ("Notice").

⁴ Amendment No. 2 is a technical amendment that reflects approval of portions of the proposed rule change by the Exchange's Board of Governors ("Board") and therefore is not required to be published for comment.

and management compensation committees. Phlx's audit committee is primarily charged with: (1) overseeing Phlx's financial reporting process; (2) overseeing the systems of internal controls established by management and the Exchange's Board, as well as the legal and compliance process; (3) selection and evaluation of independent auditors; and (4) direction and oversight of the internal audit function. Currently, the NASDAQ OMX audit committee also performs these functions.⁵ Phlx proposes that the responsibilities of its audit committee be performed by the NASDAQ OMX audit committee⁶ and a new regulatory oversight committee to be established by the Exchange.

Phlx also proposes to eliminate its compensation committee, and to prescribe that its duties be performed by the NASDAQ OMX compensation committee, or the full Phlx board when required. The NASDAQ OMX compensation committee considers and

⁵ The Exchange states that the NASDAQ OMX audit committee has broad authority to review the financial information that will be provided to shareholders and others, systems of internal controls, and audit, financial reporting and legal and compliance processes and, because NASDAQ OMX's financial statements are prepared on a consolidated basis that includes the financial results of NASDAQ OMX's subsidiaries, including Phlx, the NASDAQ OMX audit committee's purview necessarily includes these subsidiaries. In addition, the Exchange states that the NASDAQ OMX audit committee currently is charged with providing oversight of financial reporting and independent auditor selection for NASDAQ OMX and all of its subsidiaries, including Phlx, and the NASDAQ OMX audit committee has general responsibility for oversight of internal controls and direction and oversight of the internal audit function for NASDAQ OMX and all of its subsidiaries. See Notice, 74 FR at 40266-67.

⁶ According to the Exchange, the NASDAQ OMX audit committee is composed of four or five directors, all of whom must be independent under the standards established by Section 10A(m) of the Act and the listing rules of The NASDAQ Exchange. See NASDAQ OMX Bylaws, Section 4.13(i); NASDAQ Exchange Rules, IM-5605-3. All committee members must be able to read and understand financial statements, and at least one member must have past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background that results in the individual's financial sophistication. See NASDAQ Exchange Rules, IM-5603-3.

recommends compensation policies, programs, and practices for employees of NASDAQ OMX. According to Phlx, some employees performing work for Phlx are also employees of NASDAQ OMX, and certain senior officers of Phlx are also officers of NASDAQ OMX and other NASDAQ OMX subsidiaries because their responsibilities relate to multiple entities within the NASDAQ OMX corporate structure. As a result, NASDAQ OMX establishes compensation and compensation policy for these employees. To the extent that policies, programs, and practices must be established for any Phlx officers or employees who are not also NASDAQ OMX officers or employees, Phlx states that the Phlx Board will perform such actions without the use of a compensation committee, subject to recusal by the chief executive officer and the Stockholder Governor.

The Exchange also proposes to create a regulatory oversight committee (“ROC”) composed of three members, each of whom would be an Independent Governor.⁷ The Exchange’s ROC would carry out regulatory oversight tasks formerly performed by the audit committee. More specifically, the ROC would oversee the adequacy and effectiveness of Phlx’s regulatory and self-regulatory organization responsibilities; assess Phlx’s regulatory performance; and assist the Board and its standing committees in reviewing the regulatory plan and the overall effectiveness of Phlx’s regulatory functions. Its duties would include reviewing Phlx’s regulatory budget and inquiring into the adequacy of resources available in the budget for regulatory activities; meeting regularly with Phlx’s chief regulatory officer in executive session; and being informed about the compensation and promotion or termination of the chief regulatory officer and the corresponding justifications for such actions.

⁷ See Phlx Bylaws, Article I(p) for the definition of “Independent Governor.”

In addition, Phlx stated that, like the NASDAQ Exchange's regulatory oversight committee, the proposed ROC will have broad authority to oversee the adequacy and effectiveness of Phlx's regulatory and self-regulatory organization responsibilities, and will therefore be able to maintain oversight over controls in tandem with the NASDAQ OMX audit committee's responsibilities.⁸ In this regard, Phlx noted that it is already the practice of NASDAQ OMX's Internal Audit Department, which performs internal audit functions for all NASDAQ OMX subsidiaries, to report to the Phlx Board on all internal audit matters relating to Phlx, and that this practice would be formally reflected in the Department's written procedures.⁹ Phlx also represented that, to ensure that the Phlx board retains authority to direct the Department's activities with respect to Phlx, the Department's written procedures will be amended to stipulate that the ROC may, at any time, direct the Department to conduct an audit of a matter of concern to it and report the results of the audit both to the ROC and the NASDAQ OMX audit committee.¹⁰

Phlx also proposes to codify in its By-Laws a description of the position of chief regulatory officer. Article V, Section 5-6 of the By-Laws would provide that the chief regulatory officer will have general supervision of Phlx'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 revised By-Laws would require the chief regulatory officer to meet with the regulatory oversight committee in executive

⁸ See Notice, 74 FR at 40266.

⁹ See id.

¹⁰ See id.

session at regularly scheduled meetings, and at any time upon request of the chief regulatory officer or any member of the committee.

Finally, Phlx proposes to replace its Referee with an Options Trade Review Committee, and, as more fully described in the Notice, make conforming changes to the Exchange's rules and one of its Options Floor Procedure Advices. Currently, the Exchange's By-Laws and rules provide that the Referee is an Exchange employee (or independent contractor), supervised by the audit committee, who reviews Options Exchange Official rulings concerning the nullification and/or adjustment of transactions. In addition, the Referee can act in the capacity of an Options Exchange Official respecting initial rulings concerning requests for relief from the requirements of certain Exchange rules, Equity Floor Procedure Advices and Option Floor Procedure Advices. The proposed new Options Trade Review Committee would review Options Exchange Official rulings, but would not act in the capacity of an Options Exchange Official, even though the Referee was able to do so. In light of the time sensitivity of rendering trading decisions, the Exchange would allow the Options Trade Review Committee to act through a panel with a minimum of three committee members, of which no more than 50% may be engaged in market making activity or employed by an Exchange Member Organization whose revenues from market making activity exceed 10% of its total revenues. When needed, a panel would be selected by Exchange regulatory staff from the Committee members on a rotating basis, taking into consideration availability and prompt response as well as frequency of service, and the importance of assembling a panel quickly. Appeals of Options Exchange Official decisions would be presented to the

panel on an anonymous basis to reduce the risk of conflict or bias. Committee decisions, like Referee decisions, would not be appealable.

The Options Trade Review Committee would be appointed by the Exchange's Board pursuant to new By-Law Article X, Section 10-10 as a standing committee of the Board and would include a number of Member Representative members equal to at least 20% of the total number of members of the Committee. No more than 50% of committee members can be engaged in market making activity or employed by an Exchange Member Organization whose revenues from market making activity exceed 10% of its total revenues.

II. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹¹ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(1) of the Act,¹² which requires a national securities exchange to be so organized and have the capacity to carry out the purposes of the Act and to comply, and to enforce compliance by its members and persons associated with its members, with the provisions of the Act. The Commission also finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,¹³ in that it is designed, among other things, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and

¹¹ In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹² 15 U.S.C. 78(b)(1).

¹³ 15 U.S.C. 78f(b)(5).

perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Commission finds that the proposed elimination of the Phlx's audit and management compensation committees is consistent with the Act. The Commission previously approved a structure in which certain committees of the board of directors of NYSE Euronext, including the audit and compensation committees, were authorized to perform functions for various subsidiaries, including the New York Stock Exchange, LLC ("NYSE").¹⁴ More recently, the Commission approved proposals by the NASDAQ Exchange and BX to eliminate their respective audit and compensation committees.¹⁵

The Commission further finds that the elimination of the Referee position and its replacement with the Options Trade Review Committee is consistent with the Act. The compositional requirements for the Committee and committee panels, the rotating service of panel members, and the anonymous presentation of appeals of Options Exchange Official decisions to a panel of the Committee are designed to assure impartial review of those decisions.

Finally, the Commission finds that the proposals relating to codifying the position of chief regulatory officer and creating a regulatory oversight committee to oversee all regulatory initiatives are designed to allow the Exchange to carry out its regulatory obligations and are consistent with the Act.

¹⁴ Securities Exchange Act Release No. 55293 (February 14, 2007), 72 FR 8033 (February 22, 2007) (SR-NYSE-2006-120).

¹⁵ See Securities Exchange Act Release Nos. 60276 (July 9, 2009), 74 FR 34840 (July 17, 2009) (SR-NASDAQ-2009-042) and 60247 (July 17, 2009), 74 FR 33495 (July 13, 2009) (SR-BX-2009-021).

III. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁶ that the proposed rule change (SR-Phlx-2009-59), as modified by Amendment Nos. 1 and 2, be, and it hereby is, approved.

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

Florence E. Harmon
Deputy Secretary

¹⁶ 15 U.S.C. 78s(b)(2).

¹⁷ 17 CFR 200.30-3(a)(12).