

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-61862; File No. SR-Phlx-2010-43)

April 7, 2010

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by NASDAQ OMX PHLX, Inc. Relating to Quote Spread Parameters and Batching of Violations

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on March 26, 2010, NASDAQ OMX PHLX, Inc. ("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, pursuant to Section 19(b)(1) of the Act³ and Rule 19b-4 thereunder,⁴ proposes to amend Options Floor Procedure Advice ("Advice") F-6, Option Quote Parameters, to copy from Rule 1014(c)(i)(A) a provision relating to \$5 wide bid-ask differentials for electronic quotes in equity, index and foreign currency options after the opening, which was inadvertently omitted from Advice F-6. The Exchange also proposes to change the fine schedule to add three warning letters, implement the fine schedule on a one year running calendar basis, and permit the "batching" of violations of both Advice F-6 and the corresponding Rule 1014(c)(i)(A), pursuant to Rules 960 and 970, for purposes of determining what is an occurrence.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(1).

⁴ 17 CFR 240.19b-4.

The text of the proposed rule change is available on the Exchange's Website at <http://www.nasdaqtrader.com/micro.aspx?id=PHLXRulefilings>, 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 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

The purpose of the proposed rule change is to correct Advice F-6 and update it in order to reflect the current trading environment, as well as to permit the batching of certain such violations, as described below. Currently, Rule 1014(c)(i)(A) and its corresponding Advice F-6, which is part of the Exchange's minor rule plan,⁵ govern bid/ask differentials, which are also known as quotation or quote spread parameters; quote spread parameters establish the maximum permissible width between the bid and an offer in a particular series.⁶ The Exchange proposes to update Advice F-6 to reflect language permitting options quoted electronically to be quoted with

⁵ The Exchange's minor rule plan consists of options floor procedure advices ("OFPAs" or "Advices") with preset fines, pursuant to Rule 19d-1(c) under the Act. 17 CFR 240.19d-1(c). Most OFPAs have corresponding options rules.

⁶ See Rule 1014(c)(i)(A)(1)(a).

a \$5 wide spread after the opening of an option. Those who are quoting verbally (in open outcry) must, throughout the trading day, comply with the regular quote spread parameters that apply on the opening; those quote spread parameters appear in a chart in Advice F-6 and in the text of Rule 1014(c)(i)(A)(1)(a). The language permitting \$5 wide quote spreads after the opening for those quoting electronically was added to Rule 1014(c)(i)(A)(2) but, inadvertently, not to Advice F-6.⁷ The Exchange proposes to correct this by inserting this language into Advice F-6.

The Exchange also proposes to change the fine schedule applicable to Advice F-6, which is administered pursuant to the Exchange's minor rule plan. The fine schedule would now consist of warning letters respecting the first three occurrences and three fines thereafter (\$250, \$500 and \$1,000), before the seventh occurrence would result in referral to the Business Conduct Committee ("BCC") for disciplinary action. In addition, the fine schedule would be administered on a one year running calendar basis, such that violations within one year of the last occurrence would count as the next "occurrence," rather than a two year running calendar basis.⁸

⁷ See Securities Exchange Act Release No. 50728 (November 23, 2004), 69 FR 69982 (December 1, 2004) (SR-Phlx-2004-74).

⁸ A running calendar basis means that violations within a one year period count as the next "occurrence" for purposes of the fine schedule, regardless of the calendar year. A "one-year running calendar basis" means that a violation of an Advice that occurs within one year of the first violation of that Advice will be treated as a second occurrence, and any violation of an Advice within one year of the previous violation of that Advice will be subject to the next highest fine specified in the Advice. See Securities Exchange Act Release No. 41201 (March 22, 1999), 64 FR 15391 (March 31, 1999) (SR-Phlx-99-06). The terms "running" and "rolling" calendar basis are often used interchangeably. See, e.g., Securities Exchange Act Release No. 33130 (November 2, 1993), 58 FR 29502 (November 9, 1993) (SR-Phlx-93-28).

The Exchange believes that these changes are appropriate because quoting has become entirely electronic; most Streaming Quote Traders (“SQTs”) and Remote Streaming Quote Traders (“RSQTs”)⁹ quote electronically, relying on their firm’s quoting technology and computer models to establish an option’s price and generate the quote electronically to the Exchange. Historically, when Registered Options Traders (“ROT”) ¹⁰ quoting on the Exchange did so verbally (even though they relied on computer models to produce a price), the quote was subject to their own judgment and verbal delivery; sometimes an ROT stated a quote that did not comply with the maximum quote spread parameter, thus triggering a violation under Advice F-6 and a fine under the minor rule plan. In contrast, today, the Exchange believes that computer models do not make the sorts of individualized mistakes that Advice F-6 was intended to deal with; instead, when there is a quoting error today, electronically, it usually affects every series that RSQT or SQT is quoting on that particular technology, generating, potentially, hundreds of instances of quote spread parameter violations. Rather than taking each event to the BCC as a fourth occurrence under the current rule (because there may be hundreds), the Exchange proposes to treat these as a single occurrence by “batching” the violations. This way, the firm would receive a warning letter for the first three events, before being subject to a fine schedule. Of course, the Exchange could in any particular situation deem it to be egregious rather than “minor” and refer it directly to the BCC for disciplinary action. The Exchange believes that this is appropriate because the relevant warning letter or monetary fine should serve as a deterrent

⁹ See Rule 1014(b)(ii).

¹⁰ See Rule 1014(b)(i).

against future violations, while recognizing that a single programming error can have a widespread effect.

Currently, Rules 960.2(f)(ii) and 970.01 permit the Exchange to aggregate or “batch” multiple numbers of violations as one single offense, for purposes of initiating disciplinary action under Exchange rules, or imposing fines pursuant to fine schedules set forth in the relevant Options Floor Procedure Advices under the Exchange's minor rule plan.¹¹ Violations that are currently eligible for batching are listed on the Exchange's internal Numerical Criteria for Bringing Cases for Violations of Phlx Order Handling Rules. At this time, the Exchange proposes to permit batching with respect to Advice F-6 and Rule 1014(c)(i)(A), and proposes to amend Rules 960 and 970 accordingly. Currently, the language in both rules limits batching to certain Exchange order handling rules.

Pursuant to Rules 960.2(f)(ii) and 970.01, the batching program will continue to require that the violations be determined based on an exception-based surveillance program, with the specific surveillance guidelines (which are similar to compliance thresholds) maintained on the Numerical Criteria for Bringing Cases for Violations of Phlx Order Handling Rules.¹² The Exchange believes that these changes should result in a fine schedule that better fits the current

¹¹ The Exchange may also refer the matter to the Business Conduct Committee ("BCC") for possible disciplinary action when the Exchange determines that there exists a pattern or practice of violative conduct without exceptional circumstances or when any single instance of violative conduct without exceptional circumstances is deemed to be egregious. See Securities Exchange Act Release No. 45570 (March 15, 2002), 67 FR 13395 (March 22, 2002) (SR-Phlx-2001-114).

¹² Such criteria can be updated subject to the Exchange providing notice to the Commission's Office of Compliance Inspections and Examinations. See Securities Exchange Act Release No. 45570 (March 15, 2002), 67 FR 13395 (March 22, 2002) (SR-Phlx-2001-114). Because neither is an “order handling rule,” the Exchange is proposing herein to expressly permit batching of violations of Advice F-6 and Rule 1014(c)(i)(A).

electronic trading environment. In addition, the Exchange believes that Advice F-6 (and its corresponding rule) is appropriate for batching because the automated surveillance for quote spread parameter compliance,¹³ as well as the issuance of sanctions pursuant to the minor rule plan,¹⁴ will be conducted daily. The Exchange believes that its representation by regulatory staff that daily surveillance will be conducted and daily sanctions will be administered should serve as a strong deterrent against future violations.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act¹⁵ in general, and furthers the objectives of Section 6(b)(5) of the Act¹⁶ 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. The Exchange also believes that its proposal is consistent with Sections 6(b)(1) and (6) of the Act,¹⁷ which require that the rules of an exchange enforce compliance with, and provide appropriate discipline for, violations of Commission and Exchange rules. In addition, because existing Rule 970 provides procedural rights to a person fined under the minor rule plan to contest the fine and permits a hearing on the matter, the Exchange believes

¹³ See confidential letters from Stephen M. Pettibone, Managing Director Surveillance, Phlx, to Michael Gaw, Division of Trading and Markets, and Tina Barry, Office of Compliance Inspections and Examinations, Securities and Exchange Commission, dated October 6, 2009 and December 30, 2009.

¹⁴ See letter from Charles Rogers, Chief Regulatory Officer, Phlx, to Tina Barry, Office of Compliance Inspections and Examinations and Michael Gaw, Division of Trading and Markets, Securities and Exchange Commission, dated February 18, 2010.

¹⁵ 15 U.S.C. 78f(b).

¹⁶ 15 U.S.C. 78f(b)(5).

¹⁷ 15 U.S.C. 78f(b)(1) and (6).

that the proposal is consistent with Sections 6(b)(7) and 6(d)(1) of the Act,¹⁸ by providing a fair procedure for the disciplining of members and persons associated with members.

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

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

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

No written comments were either solicited or received.

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission shall: (a) by order approve such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be 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:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

¹⁸ 15 U.S.C. 78f(b)(7) and (d)(1).

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-Phlx-2010-43 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-Phlx-2010-43. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information

that you wish to make available publicly. All submissions should refer to File Number SR-Phlx-2010-43 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.¹⁹

Florence E. Harmon
Deputy Secretary

¹⁹ 17 CFR 200.30-3(a)(12) and 200.30-3(a)(44).