

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * <input type="text" value="22"/>	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4	File No.* SR - <input type="text" value="2013"/> - * <input type="text" value="05"/>	Amendment No. (req. for Amendments *) <input type="text"/>
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Filing by **NASDAQ OMX PHLX LLC.**  
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * <input checked="" type="checkbox"/>	Amendment * <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) * <input checked="" type="checkbox"/>	Section 19(b)(3)(A) * <input type="checkbox"/>	Section 19(b)(3)(B) * <input type="checkbox"/>
			Rule		
Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action * <input type="checkbox"/>	Date Expires * <input type="text"/>	<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	<input type="checkbox"/> 19b-4(f)(6)
			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010 Section 806(e)(1) <input type="checkbox"/> Section 806(e)(2) <input type="checkbox"/>	Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934 Section 3C(b)(2) <input type="checkbox"/>
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Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
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**Description**

Provide a brief description of the action (limit 250 characters, required when Initial is checked \*).

A proposal to amend Rule 1092, Obvious Errors and Catastrophic Errors. Specifically, Phlx proposes to amend Rule 1092(f)(ii) to permit the nullification of trades involving catastrophic errors in certain situations.

**Contact Information**

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name * <input type="text" value="Edith"/>	Last Name * <input type="text" value="Hallahan"/>
Title * <input type="text" value="Associate General Counsel"/>	
E-mail * <input type="text" value="edith.hallahan@nasdaqomx.com"/>	
Telephone * <input type="text" value="(215) 496-5179"/>	Fax <input type="text" value="(215) 496-6729"/>

**Signature**

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

(Title \*)

Date <input type="text" value="01/10/2013"/>	<input type="text" value="Executive Vice President and General Counsel"/>
By <input type="text" value="Edward S. Knight"/>	<input style="background-color: #cccccc;" type="text" value="Edward S Knight,"/>

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFF website.

**Form 19b-4 Information \***

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change \***

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies**

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**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

(a) 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> NASDAQ OMX PHLX LLC (“Phlx” or “Exchange”) proposes to amend Rule 1092, Obvious Errors and Catastrophic Errors. Specifically, Phlx proposes to amend Rule 1092(f)(ii) to permit the nullification of trades involving catastrophic errors in certain situations specified below.

A notice of the proposed rule change for publication in the Federal Register is attached hereto as Exhibit 1. The text of the proposed rule change is set forth below.

Proposed new language is underlined; proposed deletions are in brackets.

\* \* \* \* \*

**Rule 1092. Obvious Errors and Catastrophic Errors**

The Exchange shall either nullify a transaction or adjust the execution price of a transaction that results in an Obvious Error as provided in this Rule.

(a) – (e) No change.

(f) *Catastrophic Error Procedure.*

(i) *Notification.* If an Exchange member believes that it participated in a transaction that qualifies as a Catastrophic Error pursuant to paragraph (a)(ii) above, it must notify the Exchange's Regulatory staff by 8:30 am ET, on the first trading day following the date on which the Catastrophic Error occurred. For transactions in an expiring options series that take place on an expiration day, an Exchange member must notify the Exchange by 5:00 pm ET that same day. Relief will not be granted under this paragraph: (i) unless notification is made within the prescribed time period; and (ii) if an Options Exchange Official has previously rendered a decision with respect to the transaction in question pursuant to Rule 1092(e).

(ii) *Catastrophic Error determination.* An Options Exchange Official will determine whether the transaction(s) qualifies as a Catastrophic Error. If it is determined that a Catastrophic Error has occurred, the Options Exchange Official will adjust the execution price(s) of the transaction(s) according to subparagraph (f)(iii) below, as long as the

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

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

adjusted price would not exceed the limit price of a non-broker-dealer customer's limit order, in which case the non-broker-dealer customer would have 20 minutes from notification of the proposed adjusted price to accept it or else the trade will be nullified. If it is determined that a Catastrophic Error has not occurred, the member requesting the determination will be subject to a charge of \$5,000.

(iii) – (iv) No change.

(g) No change.

*Commentary:* -----

**.01 - .02** No change.

\* \* \* \* \*

(b) Not applicable.

(c) Not applicable.

## 2. Procedures of the Self-Regulatory Organization

The Board of Directors of the Exchange approved the submission of this proposed rule change on November 30, 2012. No other action by the Exchange is necessary for the filing of the rule change. Questions and comments on the proposed rule change may be directed to Edith Hallahan, Principal Associate General Counsel, The NASDAQ OMX Group, Inc., at 215-496-5179.

## 3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

### a. Purpose

The purpose of the proposal is to help market participants better manager their risk by addressing the situation where, under current rules, a trade can be adjusted to a price outside of a customer's limit. Specifically, the Exchange proposes to amend Rule 1092(f) to enable a non-broker-dealer customer who is the contra-side to a trade that is deemed to be a catastrophic error to have the trade nullified in instances where the

adjusted price would violate the customer's limit price. Only if the customer, or his agent, affirm the customer's willingness to accept the adjusted price through the customer's limit price within 20 minutes of notification of the catastrophic error ruling would the trade be adjusted; otherwise it would be nullified. Today, all catastrophic error trades are adjusted, not nullified, on all of the options exchanges.

### Background

Currently, Rule 1092 governs obvious and catastrophic errors. Obvious errors are calculated under the rule by determining a theoretical price and determining, based on objective standards, whether the trade should be nullified or adjusted. The rule also contains a process for requesting an obvious error review. Certain more substantial errors may fall under the category of a catastrophic error, for which a longer time period is permitted to request a review and for which trades can only be adjusted (not nullified). Trades are adjusted pursuant to an adjustment table that, in effect, assesses an adjustment penalty. By adjusting trades above or below the theoretical price, the Rule assesses a "penalty" in that the adjustment price is not as favorable as the amount the party making the error would have received had it not made the error.

### Proposal

At this time, the Exchange proposes to change the catastrophic error process to permit certain trades to be nullified. The definition and calculation of a catastrophic error would not change.<sup>3</sup> Once a catastrophic error is determined by Exchange staff, then if both parties to the trade are not a non-broker-dealer customer, then the trade would be adjusted under the current rule. If one of the parties is a non-broker-dealer customer, then

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<sup>3</sup> Nor is the definition or process for obvious errors changing.

the adjusted price would be compared to the limit price of the order. If the adjusted price would violate the limit price (in other words, be higher than the limit price if it is a buy and lower than the limit price if it is a sell order), then the customer would be offered an opportunity to nullify the trade. If the customer (or the customer's broker-dealer agent) does not respond within 20 minutes, the trade would be adjusted under the current rule.

These changes should ensure that a customer is not forced into a situation where the original limit price is violated and thereby the customer is forced to spend additional dollars for a trade at a price the customer had no interest in trading and may not be able to afford. For example, if a trade of 10 contracts occurs between two participants at \$25, and the option's theoretical price is \$75, the current rule calls for an adjustment to \$68 (\$75 less a \$7 adjustment penalty to the seller). This requires the \$25 buyer of 10 contracts, whose bid is equivalent to \$25,000<sup>4</sup> to spend \$68,000<sup>5</sup> for the trade, or an additional \$43,000.

As a second example, consider a non-broker-dealer customer order to buy 10 contracts at \$.01, for a total dollar amount of \$10. Assume that after purchasing the 10 contracts at \$.01, the buyer proceeded to sell the ten contracts later in the day at \$3.00. Further assume that with the option trading later in the day at \$6.00, the first trade is later determined to be a catastrophic error. The current rule would require an adjustment in price. If the option's theoretical price at the time of the catastrophic error was \$4.50, the current rule calls for an adjustment to \$2.50 (\$4.50 less a \$2 adjustment penalty to the seller). Opting to retain the trade with the adjustment would likely make the non-broker-

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<sup>4</sup> Most options contracts use a 100 price multiplier, such that one \$25 contract actually costs \$2500 and 10 contracts at \$25 costs \$25,000.

<sup>5</sup> Using a multiplier of 100, a contract priced at \$68 would cost \$6800. Ten contracts at \$68 would cost \$68,000.

dealer customer whole, and the buyer would likely choose to keep the trade with an adjusted price of \$2.50, even though that is through the customer's original limit price of \$2.50, because the customer sold the options for \$3.00. This illustrates the need for the non-broker dealer customer to have a choice in order to manage his risk. By applying a notification time limit of 20 minutes, it lessens the likelihood that the customer will try to let the direction of the market for that option dictate his decision for a long period of time thus exposing the contra side to more risk.

For a market maker or a broker-dealer, the penalty that is part of the price adjustment process is usually enough to offset the additional dollars spent, and they can often trade out of the position with little risk and a potential profit. For a customer who is not immersed in the day- to-day trading of the markets, this risk may be unacceptable. A customer is also less likely to be watching trading activity in a particular option throughout the day and less likely to be closely focused on the execution reports the customer receives after a trade is executed. Accordingly, the Exchange believes that it is fair and reasonable, and consistent with statutory standards, to change the procedure for catastrophic errors for customers and not for other participants.

The Exchange believes that the proposal is a fair way to address the issue of a customer's limit price, yet still balance the competing interests of certainty that trades stand versus dealing with true errors. When Rule 1092 was first adopted, the Commission stated that it "...considers that in most circumstances trades that are executed between parties should be honored. On rare occasions, the price of the executed trade indicates an 'obvious error' may exist, suggesting that it is unrealistic to expect that the parties to the trade had come to a meeting of the minds regarding the terms of the

transaction. In the Commission's view, the determination of whether an 'obvious error' has occurred, and the adjustment or nullification of a transaction because an obvious error is considered to exist, should be based on specific and objective criteria and subject to specific and objective procedures... The Commission believes that Phlx's proposed obvious error rule establishes specific and objective criteria for determining when a trade is an "obvious error." Moreover, the Commission believes that the Exchange's proposal establishes specific and objective procedures governing the adjustment or nullification of a trade that resulted from an "obvious error."<sup>6</sup> Since 2004, Phlx has been administering this rule with respect to options trading.

In 2008, the Exchange amended Rule 1092 to adopt the catastrophic error provision. In doing so, the Exchange stated that it had "weighed carefully the need to assure that one market participant is not permitted to receive a windfall at the expense of another market participant that made an Obvious Error, against the need to assure that market participants are not simply being given an opportunity to reconsider poor trading decisions. The Exchange states that, while it believes that the Obvious Error Rule strikes the correct balance in most situations, in some extreme situations, trade participants may not be aware of errors that result in very large losses within the time periods currently required under the rule. In this type of extreme situation, the Exchange believes its members should be given more time to seek relief so that there is a greater opportunity to mitigate very large losses and reduce the corresponding large wind-falls. However, to maintain the appropriate balance, the Exchange believes members should only be given

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<sup>6</sup> See Securities Exchange Act Release No. 49785 (May 28, 2004)(SR-Phlx-2003-68).

more time when the execution price is much further away from the theoretical price than is required for Obvious Errors so that relief is only provided in extreme circumstances.”<sup>7</sup>

The Exchange believes that this proposal is consistent with those principles because it strikes the aforementioned balance. The Exchange is proposing to amend Exchange Rule 1092 to eliminate the risk associated with (non-broker-dealer) customers receiving an adjustment to a trade that is outside of the limit price of their order, when there is a catastrophic error ruling respecting their trade. The new provision would continue to entail specific and objective procedures. Furthermore, the new provision more fairly balances the potential windfall to one market participant against the potential reconsideration of a trading decision under the guise of an error.

The obvious and catastrophic error rules of the options exchanges are similar, especially with respect to only adjusting trades that result in a catastrophic error. Nevertheless, the Exchange believes, based on the aforementioned example and member requests, that this aspect of the catastrophic error process should change, as explained above. The Exchange staff has focused on this particular situation because of a recent catastrophic error ruling that resulted in an appeal pursuant to Rule 1092(f)(iv). On appeal, the committee was concerned whether market participants are aware of how options exchange catastrophic errors are handled and whether the rule should be revisited. Relatedly, members of SIFMA’s Options Committee also expressed concern during a recent meeting that this particular outcome may not be appropriate. Accordingly, the Exchange has determined to amend the rule.

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<sup>7</sup> See Securities Exchange Act Release No. 58002 (June 23, 2008), 73 FR 36581 (June 27, 2008)(SR-Phlx-2008-42)(Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Catastrophic Errors).

b. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>8</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>9</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, by helping Exchange members better manage the risk associated with potential erroneous trades. Specifically, the Exchange believes that the proposal is consistent with these principles because it provides a fair process for customers to address catastrophic errors involving a limit order. In particular, the proposal still permits nullification in certain situations. Further, it gives customers a choice. The proposal sets forth an objective process based on specific and objective criteria and subject to specific and objective procedures. In addition, the Exchange has again weighed carefully the need to assure that one market participant is not permitted to receive a windfall at the expense of another market participant that made a catastrophic error, against the need to assure that market participants are not simply being given an opportunity to reconsider poor trading decisions. Accordingly, the Exchange has determined that introducing a nullification procedure for catastrophic errors is appropriate and consistent with the Act.

4. 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. Currently, most options exchanges have similar, although not identical, rules

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

<sup>9</sup> 15 U.S.C. 78f(b)(5).

regarding catastrophic errors. To the extent that this proposal would result in Phlx's rule being different, market participants may choose to route orders to Phlx, helping Phlx compete against other options exchanges for order flow based on its customer service by having a process more responsive to current market needs. Of course, other options exchanges may choose to adopt similar rules. Overall, the proposal is intended to help market participants better manage the risk associated with potential erroneous options trades and does not impose a burden on competition.

5. 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.

6. Extension of Time Period for Commission Action

The Exchange does not consent to an extension of the time period for Commission action.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advanced Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

1. Exhibit 1, Notice of proposed rule for publication in the Federal Register.

**EXHIBIT 1**

SECURITIES AND EXCHANGE COMMISSION  
(Release No. \_\_\_\_\_ ; File No. SR-Phlx-2013-05)

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by NASDAQ OMX PHLX LLC Regarding Obvious Errors and Catastrophic Errors

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup>, and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on January 10, 2013, NASDAQ OMX 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 is filing with the Commission a proposal to amend Rule 1092, Obvious Errors and Catastrophic Errors. Specifically, Phlx proposes to amend Rule 1092(f)(ii) to permit the nullification of trades involving catastrophic errors in certain situations specified below.

The text of the proposed rule change is set forth below. Proposed new language is underlined; proposed deletions are in brackets.

\* \* \* \* \*

**Rule 1092. Obvious Errors and Catastrophic Errors**

The Exchange shall either nullify a transaction or adjust the execution price of a transaction that results in an Obvious Error as provided in this Rule.

(a) – (e) No change.

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

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

(f) *Catastrophic Error Procedure.*

(i) *Notification.* If an Exchange member believes that it participated in a transaction that qualifies as a Catastrophic Error pursuant to paragraph (a)(ii) above, it must notify the Exchange's Regulatory staff by 8:30 am ET, on the first trading day following the date on which the Catastrophic Error occurred. For transactions in an expiring options series that take place on an expiration day, an Exchange member must notify the Exchange by 5:00 pm ET that same day. Relief will not be granted under this paragraph: (i) unless notification is made within the prescribed time period; and (ii) if an Options Exchange Official has previously rendered a decision with respect to the transaction in question pursuant to Rule 1092(e).

(ii) *Catastrophic Error determination.* An Options Exchange Official will determine whether the transaction(s) qualifies as a Catastrophic Error. If it is determined that a Catastrophic Error has occurred, the Options Exchange Official will adjust the execution price(s) of the transaction(s) according to subparagraph (f)(iii) below, as long as the adjusted price would not exceed the limit price of a non-broker-dealer customer's limit order, in which case the non-broker-dealer customer would have 20 minutes from notification of the proposed adjusted price to accept it or else the trade will be nullified. If it is determined that a Catastrophic Error has not occurred, the member requesting the determination will be subject to a charge of \$5,000.

(iii) – (iv) No change.

(g) No change.

**Commentary:** -----

**.01 - .02** No change.

\* \* \* \* \*

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 proposal is to help market participants better manager their risk by addressing the situation where, under current rules, a trade can be adjusted to a price outside of a customer's limit. Specifically, the Exchange proposes to amend Rule 1092(f) to enable a non-broker-dealer customer who is the contra-side to a trade that is deemed to be a catastrophic error to have the trade nullified in instances where the adjusted price would violate the customer's limit price. Only if the customer, or his agent, affirm the customer's willingness to accept the adjusted price through the customer's limit price within 20 minutes of notification of the catastrophic error ruling would the trade be adjusted; otherwise it would be nullified. Today, all catastrophic error trades are adjusted, not nullified, on all of the options exchanges.

Background

Currently, Rule 1092 governs obvious and catastrophic errors. Obvious errors are calculated under the rule by determining a theoretical price and determining, based on objective standards, whether the trade should be nullified or adjusted. The rule also contains a process for requesting an obvious error review. Certain more substantial errors may fall under the category of a catastrophic error, for which a longer time period is permitted to request a review and for which trades can only be adjusted (not nullified). Trades are adjusted pursuant to an adjustment table that, in effect, assesses an adjustment penalty. By adjusting trades above or below the theoretical price, the Rule assesses a "penalty" in that the adjustment price is not as favorable as the amount the party making the error would have received had it not made the error.

Proposal

At this time, the Exchange proposes to change the catastrophic error process to permit certain trades to be nullified. The definition and calculation of a catastrophic error would not change.<sup>3</sup> Once a catastrophic error is determined by Exchange staff, then if both parties to the trade are not a non-broker-dealer customer, then the trade would be adjusted under the current rule. If one of the parties is a non-broker-dealer customer, then the adjusted price would be compared to the limit price of the order. If the adjusted price would violate the limit price (in other words, be higher than the limit price if it is a buy and lower than the limit price if it is a sell order), then the customer would be offered an opportunity to nullify the trade. If the customer (or the customer's broker-dealer agent) does not respond within 20 minutes, the trade would be adjusted under the current rule.

These changes should ensure that a customer is not forced into a situation where the original limit price is violated and thereby the customer is forced to spend additional dollars for a trade at a price the customer had no interest in trading and may not be able to afford. For example, if a trade of 10 contracts occurs between two participants at \$25, and the option's theoretical price is \$75, the current rule calls for an adjustment to \$68 (\$75 less a \$7 adjustment penalty to the seller). This requires the \$25 buyer of 10 contracts, whose bid is equivalent to \$25,000<sup>4</sup> to spend \$68,000<sup>5</sup> for the trade, or an additional \$43,000.

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<sup>3</sup> Nor is the definition or process for obvious errors changing.

<sup>4</sup> Most options contracts use a 100 price multiplier, such that one \$25 contract actually costs \$2500 and 10 contracts at \$25 costs \$25,000.

<sup>5</sup> Using a multiplier of 100, a contract priced at \$68 would cost \$6800. Ten contracts at \$68 would cost \$68,000.

As a second example, consider a non-broker-dealer customer order to buy 10 contracts at \$.01, for a total dollar amount of \$10. Assume that after purchasing the 10 contracts at \$.01, the buyer proceeded to sell the ten contracts later in the day at \$3.00. Further assume that with the option trading later in the day at \$6.00, the first trade is later determined to be a catastrophic error. The current rule would require an adjustment in price. If the option's theoretical price at the time of the catastrophic error was \$4.50, the current rule calls for an adjustment to \$2.50 (\$4.50 less a \$2 adjustment penalty to the seller). Opting to retain the trade with the adjustment would likely make the non-broker-dealer customer whole, and the buyer would likely choose to keep the trade with an adjusted price of \$2.50, even though that is through the customer's original limit price of \$2.50, because the customer sold the options for \$3.00. This illustrates the need for the non-broker dealer customer to have a choice in order to manage his risk. By applying a notification time limit of 20 minutes, it lessens the likelihood that the customer will try to let the direction of the market for that option dictate his decision for a long period of time thus exposing the contra side to more risk.

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fair and reasonable, and consistent with statutory standards, to change the procedure for catastrophic errors for customers and not for other participants.

The Exchange believes that the proposal is a fair way to address the issue of a customer's limit price, yet still balance the competing interests of certainty that trades stand versus dealing with true errors. When Rule 1092 was first adopted, the Commission stated that it "...considers that in most circumstances trades that are executed between parties should be honored. On rare occasions, the price of the executed trade indicates an 'obvious error' may exist, suggesting that it is unrealistic to expect that the parties to the trade had come to a meeting of the minds regarding the terms of the transaction. In the Commission's view, the determination of whether an 'obvious error' has occurred, and the adjustment or nullification of a transaction because an obvious error is considered to exist, should be based on specific and objective criteria and subject to specific and objective procedures... The Commission believes that Phlx's proposed obvious error rule establishes specific and objective criteria for determining when a trade is an "obvious error." Moreover, the Commission believes that the Exchange's proposal establishes specific and objective procedures governing the adjustment or nullification of a trade that resulted from an "obvious error."<sup>6</sup> Since 2004, Phlx has been administering this rule with respect to options trading.

In 2008, the Exchange amended Rule 1092 to adopt the catastrophic error provision. In doing so, the Exchange stated that it had "weighed carefully the need to assure that one market participant is not permitted to receive a windfall at the expense of another market participant that made an Obvious Error, against the need to assure that

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<sup>6</sup> See Securities Exchange Act Release No. 49785 (May 28, 2004)(SR-Phlx-2003-68).

market participants are not simply being given an opportunity to reconsider poor trading decisions. The Exchange states that, while it believes that the Obvious Error Rule strikes the correct balance in most situations, in some extreme situations, trade participants may not be aware of errors that result in very large losses within the time periods currently required under the rule. In this type of extreme situation, the Exchange believes its members should be given more time to seek relief so that there is a greater opportunity to mitigate very large losses and reduce the corresponding large wind-falls. However, to maintain the appropriate balance, the Exchange believes members should only be given more time when the execution price is much further away from the theoretical price than is required for Obvious Errors so that relief is only provided in extreme circumstances.”<sup>7</sup>

The Exchange believes that this proposal is consistent with those principles because it strikes the aforementioned balance. The Exchange is proposing to amend Exchange Rule 1092 to eliminate the risk associated with (non-broker-dealer) customers receiving an adjustment to a trade that is outside of the limit price of their order, when there is a catastrophic error ruling respecting their trade. The new provision would continue to entail specific and objective procedures. Furthermore, the new provision more fairly balances the potential windfall to one market participant against the potential reconsideration of a trading decision under the guise of an error.

The obvious and catastrophic error rules of the options exchanges are similar, especially with respect to only adjusting trades that result in a catastrophic error. Nevertheless, the Exchange believes, based on the aforementioned example and member

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<sup>7</sup> See Securities Exchange Act Release No. 58002 (June 23, 2008), 73 FR 36581 (June 27, 2008)(SR-Phlx-2008-42)(Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Catastrophic Errors).

requests, that this aspect of the catastrophic error process should change, as explained above. The Exchange staff has focused on this particular situation because of a recent catastrophic error ruling that resulted in an appeal pursuant to Rule 1092(f)(iv). On appeal, the committee was concerned whether market participants are aware of how options exchange catastrophic errors are handled and whether the rule should be revisited. Relatedly, members of SIFMA's Options Committee also expressed concern during a recent meeting that this particular outcome may not be appropriate.

Accordingly, the Exchange has determined to amend the rule.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>8</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>9</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, by helping Exchange members better manage the risk associated with potential erroneous trades. Specifically, the Exchange believes that the proposal is consistent with these principles because it provides a fair process for customers to address catastrophic errors involving a limit order. In particular, the proposal still permits nullification in certain situations. Further, it gives customers a choice. The proposal sets forth an objective process based on specific and objective criteria and subject to specific and objective procedures. In addition, the Exchange has again weighed carefully the need to assure that one market participant is not permitted to receive a windfall at the expense of another market participant that made

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

<sup>9</sup> 15 U.S.C. 78f(b)(5).

a catastrophic error, against the need to assure that market participants are not simply being given an opportunity to reconsider poor trading decisions. Accordingly, the Exchange has determined that introducing a nullification procedure for catastrophic errors is appropriate and consistent with the Act.

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. Currently, most options exchanges have similar, although not identical, rules regarding catastrophic errors. To the extent that this proposal would result in Phlx's rule being different, market participants may choose to route orders to Phlx, helping Phlx compete against other options exchanges for order flow based on its customer service by having a process more responsive to current market needs. Of course, other options exchanges may choose to adopt similar rules. Overall, the proposal is intended to help market participants better manage the risk associated with potential erroneous options trades and does not impose a burden on competition.

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 45 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 or

disapprove 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
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-Phlx-2013-05 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-2013-05. 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 website 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 offices 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-2013-05 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>10</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>10</sup> 17 CFR 200.30-3(a)(12).