



8011-01p
SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69058; File No. SR-NASDAQ-2013-039)

March 7, 2013

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Replace the Current Mid-Point Test Applied to the Definition of Theoretical Price

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 February 26, 2013, The NASDAQ Stock Market LLC (“NASDAQ” or “Exchange”), filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II 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 has filed a proposed rule change for the NASDAQ Options Market (“NOM”) to amend Chapter V, Regulation of Trading on NOM, Section 6, Obvious Errors, to replace the current mid-point test applied to the definition of Theoretical Price, as described further below.

The text of the proposed rule change is below. Proposed new language is italicized.

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¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

Chapter V Regulation of Trading on NOM

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Sec. 6 Obvious Errors

(a) Nasdaq shall either nullify a transaction or adjust the execution price of a transaction that meets the standards provided in this Section.

(b) No change.

(c) *Definition of Theoretical Price.* For purposes of this Section only, the Theoretical Price of an option series is,

(i) If the series is traded on at least one other options exchange, the [mid-point of the] last National Best Bid price with respect to an erroneous sell transaction and the last National Best Offer price with respect to an erroneous buy transaction [and Offer (“NBBO”)], just prior to the transaction; or

(ii) No change.

(d) - (e) No change.

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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 Participants to better manage their risk by modernizing the Exchange's Obvious Errors rule. Chapter V, Section 6 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.

Currently, Chapter V, Section 6 provides that the definition of the Theoretical Price of an option is: (i) if the series is traded on at least one other options exchange, the mid-point of the National Best Bid and Offer ("NBBO"), just prior to the transaction; or (ii) if there are no quotes for comparison purposes, as determined by MarketWatch as defined in Chapter I.

The Exchange believes that in certain situations the application of the rule when determining to nullify or adjust transactions may lead to an unfair result for one of the parties to the transaction, particularly where the market for the affected series includes a bid price that is relatively small (for example, \$0.50) and a substantially higher offer (for example \$5.00). The result is that a transaction to sell that occurs correctly on the bid at

\$0.50 could be adjusted based on the midpoint of the NBBO, which is, in this example, \$2.75. In such a case, the result is unfair to the bidder at \$0.50, whose price would be adjusted based on the Theoretical Price of \$2.75, and an unjust enrichment to the seller, who is entitled to \$0.50 based on the bid, but who would receive the adjusted price of over \$2.00 higher because of the rule, and not due to market conditions.

Accordingly, the proposal would re-define “Theoretical Price” to mean either the last National Best Bid price with respect to an erroneous sell transaction or the last National Best Offer price with respect to an erroneous buy transaction, just prior to the trade. The purpose of this provision is to establish a Theoretical Price that is clearly defined when there are quotations to compare to the erroneous transaction price, and to eliminate the scenario above that arises from the “mid-point” test when the NBBO is particularly wide. The Exchange notes that other options exchanges previously employed the mid-point test but changed it to the NBBO test.

When another options exchange’s comparable rule 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.’ ”³

2. Statutory Basis

NASDAQ believes that its proposal is consistent with Section 6(b) of the Act⁴ in general, and furthers the objectives of Section 6(b)(5) of the Act⁵ in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanisms 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 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, 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 defining the Theoretical Price of an option with reference to the NBBO is appropriate and consistent with the aforementioned principles.

³ See Securities Exchange Act Release No. 49785 (May 28, 2004), 69 FR 32090 (June 8, 2004) (SR-Phlx-2003-68).

⁴ 15 U.S.C. 78f(b).

⁵ 15 U.S.C. 78f(b)(5).

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

NASDAQ 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. The proposal does not impose an intra-market burden on competition, because the new definition of Theoretical Price will apply to all Options Participants. Nor will the proposal impose a burden on competition among the options exchanges, because of the vigorous competition for order flow among the options exchanges. NOM competes with 10 other options exchanges in a highly competitive market, where market participants can easily and readily direct order flow to competing venues.

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

Written comments were neither solicited nor received.

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

Because the 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 if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act⁶ and Rule 19b-4(f)(6)(iii) thereunder.⁷

⁶ 15 U.S.C. 78s(b)(3)(A).

⁷ 17 CFR 240.19b-4(f)(6)(iii). As required under Rule 19b-4(f)(6)(iii), the Exchange provided the Commission with written notice of its intent to file the proposed rule change, along with a brief description and the text of 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.

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 necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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. Please include File Number SR-NASDAQ-2013-039 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-NASDAQ-2013-039. 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; 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-NASDAQ-2013-039 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.⁸

Kevin M. O'Neill
Deputy Secretary

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⁸ 17 CFR 200.30-3(a)(12).