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SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-73311; File No. SR-Phlx-2014-65)

October 7, 2014

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Rule 705 (Fidelity Bonds)

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 September 25, 2014, 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 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 proposes to delete certain extraneous language from Exchange Rule 705 to amend an inadvertent error in the rule text.

The text of the proposed rule change is available on the Exchange’s website at <http://nasdaqomxphlx.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 proposed rule change. The text of these statements may be examined at the places specified in

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

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

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 the text of Exchange Rule 705, entitled “Fidelity Bonds,” by deleting certain text which was not deleted when the Exchange filed to replace Rule 705<sup>3</sup> with a rule in substantially the same form as that of the Financial Industry Regulatory Authority, Inc. (“FINRA”).<sup>4</sup> Exchange Rule 705 was replaced by a new Rule 705 as of April 2, 2012, in order to harmonize the Phlx Rules with FINRA rules. The title of Exchange Rule 705 was changed from “Members Must Carry” to “Fidelity Bonds.” The Exchange intended to delete Rule 705 in its entirety and rename the rule and replace the text with new text similar to that in FINRA Rule 4360. The Exchange inadvertently did not include all of the Supplementary Material section of the Rule in the original filing so that it could be deleted. The Exchange proposes to delete the current Supplementary Material .03 to Exchange Rule 705 in accordance with the intent of the original rule proposal.

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<sup>3</sup> See Securities Exchange Act Release No. 66362 (February 9, 2012), 77 FR 8931 (February 15, 2012) (SR-Phlx-2012-13). See also Securities Exchange Act Release No. 66407 (February 16, 2012), 77 FR 10787 (February 23, 2012) (SR-Phlx-2012-21). See also Securities Exchange Act Release No. 66411 (February 16, 2012), 77 FR 10788 (February 23, 2012) (SR-NYSE-2012-04) (an immediately effective filing which incorporated the FINRA rule by merely noting the text would be the same as the FINRA rule). See also Securities Exchange Act Release No. 66412 (February 16, 2012), 77 FR 10791 (February 23, 2012) (SR-NYSEAmex-2012-08) (an immediately effective filing which incorporated the FINRA rule by merely noting the text would be the same as the FINRA rule).

<sup>4</sup> See FINRA Rule 4360 “Fidelity Bonds.”

The purpose of a fidelity bond is to protect a member organization against certain types of losses, including, but not limited to, those caused by the malfeasance of its officers and employees, and the effect of such losses on the member organization's capital. At this time the Exchange is seeking to delete rule text which covers Employee Blanket Bond Coverage in Supplementary Material .03. The rule text that the Exchange proposes to delete states that member organizations subject to minimum net capital under Rule 15c3-1 are required to have Brokers Blanket Bond Coverage with respect to employees (including officers, regardless of their duties) in amounts not less than the minimums prescribed above which apply both to partner coverage and employee blanket bond coverage. In addition to this basic Brokers Blanket Bond Coverage, “member organizations are required to include the following minimum specific coverages with respect to: MISPLACEMENT, FRAUDULENT TRADING, CHECK FORGERY and SECURITIES FORGERY, ON PREMISES AND IN TRANSIT.” Further, all employee Fidelity coverage shall be on the Standard Form 14 Stock Brokers’ Bond, Federal Insurance Company’s Form B Bond or Lloyd's form if it is the full equivalent. With respect to Misplacement, Check Forgery, On Premises and In Transit, at least the amount of the basic bond minimum requirement shall be carried. With respect to Fraudulent Trading, at least \$50,000 or 50% of the basic bond minimum requirement, whichever is greater, with a top minimum of \$500,000 shall be carried. With respect to Securities Forgery, at least \$50,000 or 25% of the basic bond minimum requirement, whichever is greater, with a top minimum of \$250,000 shall be carried.

The rule text the Exchange is proposing to delete further goes on to note that a “review for adequacy of coverage shall be made at least annually as of the anniversary date of the issuance of the bond and minimum requirements for the next twelve months shall be established by reference

to the highest net capital requirement in the preceding twelve months. Each member organization will be expected to review carefully any need for coverage greater than that provided by the required minimums. Where experience or the nature of the business warrants additional coverage the Exchange expects the member organization to acquire it.”

Each member and member organization, according to the rule text the Exchange is proposing to delete, is required to carry certain forms of insurance and advise the Exchange if such insurance is entirely or partially cancelled. Members and member organizations are required to provide details in writing within 10 days of cancellation. “A member organization which becomes eligible to elect and does elect to compute its minimum required net capital under the alternative net capital requirement set forth in paragraph (f) of Rule 15c3-1, instead of under the requirements set forth in paragraph (a) in the deleted rule text, shall determine its minimum required coverage in the same manner as specified in sections .02(b) and .03 hereof.”

Finally, the rule states that each member organization “may self-insure to the extent of \$5,000 or 10% of its minimum insurance requirement as fixed by the Exchange, whichever is greater, for each type of coverage required by the rule. The excess of any such amount self-insured over the maximum permissible self-insurance must be deducted from the member organization’s net worth in the calculation of net capital for purposes of Rule 15c3-1.”

The Exchange notes that at the time of the filing it sought to replace the current rule in its entirety and adopt the FINRA rule as noted in the original filing.<sup>5</sup> FINRA Rule 4360 requires a member (including a firm that signs a multi-year insurance policy), annually as of the yearly anniversary date of the issuance of the fidelity bond, to review the adequacy of its fidelity bond coverage and make any required adjustments to its coverage, as set forth in the rule. Under

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<sup>5</sup> See Securities Exchange Act Release No. 66362 (February 9, 2012), 77 FR 8931 (February 15, 2012) (SR-Phlx-2012-13).

FINRA Rule 4360(d), a member's highest net capital requirement during the preceding 12-month period, based on the applicable method of computing net capital (dollar minimum, aggregate indebtedness or alternative standard), is used as the basis for determining the member's minimum required fidelity bond coverage for the succeeding 12-month period. The "preceding 12-month period" includes the 12-month period that ends 60 days before the yearly anniversary date of a member's fidelity bond. This would give a firm time to determine its required fidelity bond coverage by the anniversary date of the bond.

Further, FINRA Rule 4360 allows a member that has only been in business for one year and elected the aggregate indebtedness ratio for calculating its net capital requirement to use, solely for the purpose of determining the adequacy of its fidelity bond coverage for its second year, the 15 to 1 ratio of aggregate indebtedness to net capital in lieu of the 8 to 1 ratio (required for broker-dealers in their first year of business) to calculate its net capital requirement. Notwithstanding the above, such member would not be permitted to carry less minimum fidelity bond coverage in its second year than it carried in its first year.

FINRA Rule 4360 exempts from the fidelity bond requirements members in good standing with a national securities exchange that maintain a fidelity bond subject to the requirements of such exchange that are equal to or greater than the requirements set forth in Rule 4360. Additionally, FINRA Rule 4360 continues to exempt from the fidelity bond requirements any firm that acts solely as a Designated Market Maker, floor broker or registered floor trader and does not conduct business with the public.

The Exchange intended to adopt the FINRA rule instead.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>6</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>7</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 correcting an error in the Exchange's rules in order that the Rule properly reflect the correct text. An accurate and up-to-date Rulebook will avoid confusion for market participants. This proposal is not substantive, rather, the proposal seeks to update the rules to reflect the current operation of the Exchange. The Exchange believes that the requirements of FINRA Rule 4360, including, but not limited to, requiring each member that is required to join the Securities Investor Protection Corporation to maintain blanket fidelity bond coverage, increasing the minimum requirement fidelity bond coverage and maintaining a fidelity bond that provides for per loss coverage without an aggregate limit of liability promotes investor protection by protecting firms from unforeseen losses. The proposed amendments will conform Phlx's rule to a corresponding FINRA rule, to promote application of consistent regulatory standards.

### 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. The Exchange is merely seeking to correct an inadvertent error in the rule text. The Exchange's original intent was to adopt the FINRA rule and the changes proposed herein further that intent

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

<sup>7</sup> 15 U.S.C. 78f(b)(5).

and conform the Phlx rule to the FINRA rule to promote application of consistent regulatory standards.

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) of the Act<sup>8</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>9</sup>

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative prior to 30 days after the date of filing.<sup>10</sup> Rule 19b-4(f)(6)(iii), however, permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest.<sup>11</sup> The Exchange has requested that the Commission waive the 30-day operative delay so that the Exchange can quickly correct the inadvertent error and avoid inconsistency in its rules.

The Commission believes that the waiver of the 30-day operative delay is consistent with the protection of investors and the public interest because accurate rules are important to the

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<sup>8</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>9</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.

<sup>10</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>11</sup> Id.

function of the Exchange. The proposed amendments reflect the Exchange's intent in a prior filing. Furthermore, the proposed rule change is not substantive but merely seeks to properly amend rules to reflect the current operation of the Exchange. Therefore, the Commission designates the proposal operative upon filing.<sup>12</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.<sup>13</sup> If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.<sup>14</sup>

#### 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-2014-65 on the subject line.

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<sup>12</sup> For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>13</sup> 15 U.S.C. 78s(b)(3)(C).

<sup>14</sup> Id.

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-2014-65. 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, 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-Phlx-2014-65 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>15</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>15</sup> 17 CFR 200.30-3(a)(12).