

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-57824; File No. SR-Phlx-2008-35)

May 15, 2008

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to FLEX Equity Option Opening Transactions

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 May 5, 2008, the Philadelphia Stock Exchange, Inc. ("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 Phlx. The Exchange filed the proposed rule change pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposal effective upon filing with the Commission. 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 Phlx proposes to amend Phlx Rule 1079 (FLEX Index, Equity and Currency Options) to establish a pilot program that would reduce from 250 contracts to 150 contracts the minimum value size for an opening transaction (other than FLEX Quotes

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

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

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

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

responsive to a FLEX Request for Quotes)<sup>5</sup> in any FLEX Equity Option<sup>6</sup> series in which there is no open interest at the time a FLEX Request for Quotes (“RFQ”) is submitted (the “Pilot Program”). The Exchange also proposes to modify the minimum value size for an opening transaction in a currently-opened FLEX Equity series (other than FLEX Quotes responsive to a RFQ) to the lesser of 100 contracts or the number of contracts overlying \$1 million in the underlying securities.

The text of the proposed rule change is available at the Phlx, the Commission’s Public Reference Room, and [www.phlx.com](http://www.phlx.com).

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 Phlx 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 Phlx 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 initiate a year and a half long Pilot Program that would reduce the minimum value size for an opening transaction (other

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<sup>5</sup> FLEX Quotes responsive to a FLEX Request for Quote (“RFQ”) have different parameters that are not changed by this filing. See Phlx Rule 1079(a)(8)(C).

<sup>6</sup> FLEX Equity Options are flexible exchange-traded options contracts that overlie equity securities. FLEX Equity Options provide investors with the ability to customize basic option features including size, expiration date, exercise style, and certain exercise prices. FLEX Equity Options (as also FLEX index options) may have expiration dates within five years. See Phlx Rule 1079.

than FLEX Quotes responsive to a FLEX RFQ) in any FLEX Equity Option series in which there is no open interest at the time an RFQ is submitted, and to modify the minimum value size for an opening transaction in a currently-opened FLEX Equity series (other than FLEX Quotes responsive to a FLEX RFQ). The proposed clarification of the criteria for opening FLEX option transactions should provide members that use FLEX Equity Options greater flexibility in structuring the terms of such options to better comport with the particular needs of the members and their customers.

Currently, Phlx Rule 1079(a)(8)(A) sets the minimum opening transaction value size in the case of a FLEX Equity Option in a newly established series as the lesser of (i) 250 contracts or (ii) the number of contracts overlying \$1 million in the underlying securities.<sup>7</sup> Under the Pilot Program, the Exchange proposes to reduce the "250 contracts" component to "150 contracts;" the \$1 million underlying value component will continue to apply unchanged.<sup>8</sup> The proposed Pilot Program would be similar to one that has already been approved for other options exchanges.<sup>9</sup>

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<sup>7</sup> Under this formula, an opening transaction in a FLEX Equity series in a stock priced at \$40 or more would reach the \$1 million limit before it would reach the contract size limit, *i.e.*, 250 contracts times the multiplier (100) times the stock price (\$40) equals \$1 million in underlying value. For a FLEX Equity series in a stock priced at less than \$40, the 250 contract size limit applies.

<sup>8</sup> Under this proposed formula, an opening transaction in a FLEX Equity series in a stock priced at approximately \$66.67 or more would reach the \$1 million limit before it would reach the contract size limit, *i.e.*, 150 contracts times the multiplier (100) times the stock price (\$66.67) equals just over \$1 million in underlying value. For a FLEX Equity series in a stock priced at less than \$66.67, the 150 contract size limit would apply.

<sup>9</sup> See Securities Exchange Act Release No. 57429 (March 4, 2008), 73 FR 13058 (March 11, 2008)(SR-CBOE-2006-36)("CBOE Pilot Program Order").

Given that FLEX Equity Option transactions can occur in increments of 100 or more contracts in subsequent opening transactions,<sup>10</sup> the Exchange believes it is reasonable to permit the initial series opening transaction size to be 150 contracts (or \$1 million in underlying value, whichever is less). The Exchange believes that the proposed reduction of the minimum value size for opening a series provides FLEX-participating members and their customers with greater flexibility in structuring the terms of FLEX Equity Options to better suit the FLEX traders' particular needs.

The Exchange notes that the opening size requirement for FLEX Equity Options was originally put in place to limit participation in FLEX Equity Options to sophisticated, high net worth investors rather than retail investors.<sup>11</sup> According to the Chicago Board Options Exchange, Incorporated ("CBOE"), which has a pilot program that is similar to the one proposed herein, it received requests from broker-dealers representing institutional clients that the minimum value size for opening transactions be reduced.<sup>12</sup> In proposing the reduction of the 250 contract component to 150 contracts, CBOE stated in its filing that it is cognizant of the desire to continue to provide both the requisite amount of investor protection that the minimum opening size requirement was originally

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<sup>10</sup> Specifically, for FLEX Equity Options the minimum value size for a transaction in any currently-opened FLEX series is, as proposed, the lesser of 100 contracts or the number of contracts overlying \$1 million in the underlying securities; or the lesser of 25 contracts or the remaining size in the case of a closing transaction. Additionally, the minimum value size for a FLEX Quote entered in response to a RFQ in FLEX Equity Options is the lesser of 25 contracts or the remaining size in a closing transaction. See Phlx Rules 1079(a)(8)(B)(ii) and 1079(a)(8)(C)(ii).

<sup>11</sup> The existing customer base for FLEX Options includes both institutional investors and high net worth individuals.

<sup>12</sup> See CBOE Pilot Program Order, supra note 9, at 73 FR 13059.

designed to achieve, as well as the need for market participants to have the flexibility to serve their customers' particular investment needs.<sup>13</sup>

The Exchange believes that modifying the minimum opening transaction value size in this way will further broaden the base of institutional investors that use FLEX Equity Options to manage their trading and investment risk, including investors that currently trade in the over-the-counter market for customized options that can take on contract characteristics similar to FLEX Options but for which similar opening size restrictions do not apply. The Exchange believes that market participants benefit from being able to trade these customized options in an exchange environment in several ways, including, but not limited to, enhanced efficiency in initiating and closing out positions; increased market transparency; and heightened contra-party creditworthiness due to the role of The Options Clearing Corporation as issuer and guarantor of FLEX Equity Options.

Should the Exchange desire to propose an extension, expansion, or permanent implementation of the Pilot Program, the Exchange would submit, along with a filing proposing any necessary amendments to the Pilot Program, a pilot program report.<sup>14</sup> The

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<sup>13</sup> See id.

<sup>14</sup> At a minimum the report must provide (i) data and analysis on the open interest and trading volume in FLEX Equity Options for which series were opened with a minimum opening size of 150 to 249 contracts and less than \$1 million in underlying value; and (ii) analysis on the types of investors that initiated opening FLEX Equity Options transactions (i.e., institutional, high net worth, or retail, if any). The proposed reporting requirements for the instant proposal are identical to the CBOE Pilot Program. This information was confirmed pursuant to a telephone conversation between Jurij Trypupenko, Director and Counsel, Phlx and Marc McKayle, Special Counsel, Division of Trading and Markets, SEC on May 12, 2008.

report would be submitted to the Commission at least ninety days prior to the expiration date of the one-and-a-half year Pilot Program.

Finally, the Exchange is also proposing to modify the minimum value size for an opening transaction in a currently-opened FLEX Equity series (other than FLEX Quotes responsive to a FLEX RFQ). Presently, Phlx Rule 1079(a)(8)(B) sets the minimum transaction value size for an opening transaction in a currently-opened series at 100 contracts. The Exchange is proposing to modify the minimum size formula to the lesser of (i) 100 contracts or (ii) the number of contracts overlying \$1 million in the underlying securities. This change would only impact those FLEX Equity series in which the underlying stock is trading at more than \$100.<sup>15</sup>

The FLEX minimum size requirements for subsequent opening transactions in a currently-opened series is higher for certain stocks priced over \$100 than the minimum size needed to initially open the series in similarly priced stocks. The Exchange therefore believes that this proposal is necessary for there to be consistency between the minimum size requirements for new series and currently-opened series when the underlying stock is trading at more than \$100.<sup>16</sup>

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<sup>15</sup> Under this proposed formula, a transaction in a currently-opened FLEX Equity series in a stock priced at more than \$100 would reach the \$1 million limit before it would reach the contract size limit, i.e., 100 contracts times the multiplier (100) times the stock price (\$100) equals \$1 million in underlying value.

<sup>16</sup> For example, a new FLEX Equity series in a stock trading at \$110 could open with an initial transaction size of 91 contracts, i.e., 91 contracts times the multiplier (100) times the stock price (\$110) equals just over \$1 million in underlying value. Once the series is opened, absent the proposed change, any further opening transactions would require a minimum contract size of 100 contracts, despite the fact that with the stock price of \$110, this would be valued at \$1.1 million, more than the value of the initial opening transaction.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>17</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>18</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, among other things, lowering from 250 to 150 the minimum number of contracts required to open a FLEX series and thereby providing FLEX-participating members and their customers greater flexibility to trade FLEX Equity Options.

### 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

The Exchange has designated the proposed rule change as one that may take effect upon filing with the Commission pursuant to Section 19(b)(3)(A) of the Act<sup>19</sup> and

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<sup>17</sup> 15 U.S.C. 78f(b).

<sup>18</sup> 15 U.S.C. 78f(b)(5).

<sup>19</sup> 15 U.S.C. 78s(b)(3)(A).

Rule 19b-4(f)(6)(iii) thereunder<sup>20</sup> because it 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.<sup>21</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. 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. The Exchange requested that the Commission waive the 30-day operative delay and designate the proposed rule change immediately operative, so the Exchange can implement the rule change, which is based on a CBOE proposal recently approved by the Commission, without delay.<sup>22</sup> The Exchange believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest in that it would provide it with the ability to trade products that are traded or available on other options exchanges.

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<sup>20</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>21</sup> In addition, Rule 19b-4(f)(6)(iii) requires a self-regulatory organization to give the Commission written notice of its intent to file a proposed rule change, along with a brief description and 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. The Exchange has fulfilled this requirement. In particular, the Commission notes that the proposal was originally designated under Section 19(b)(2) of the Act (File No. SR-Phlx-2008-29). Following a conversation with Commission staff, the Phlx withdrew that filing and submitted the present filing designated for immediate effectiveness under Section 19(b)(3)(A).

<sup>22</sup> See CBOE Pilot Program Order, supra note 9.



The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest.<sup>23</sup> Therefore, the Commission designates the proposal to be operative upon filing.

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate 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](mailto:rule-comments@sec.gov). Please include File Number SR-Phlx-2008-35 on the subject line.

##### Paper comments:

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

All submissions should refer to File Number SR-Phlx-2008-35. This file number should be included on the subject line if e-mail is used. To help the Commission process and

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<sup>23</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).

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 inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of the Phlx. 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-2008-35 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>24</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>24</sup> 17 CFR 200.30-3(a)(12).