

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-58995; File No. SR-Phlx-2008-74)

November 21, 2008

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the NASDAQ OMX PHLX, Inc. Relating to Automated Openings in Index Options

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 November 20, 2008, the NASDAQ OMX PHLX, Inc. (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange, pursuant to Section 19(b)(1) of the Act<sup>3</sup> and Rule 19b-4 thereunder,<sup>4</sup> proposes to amend Exchange Rules 1017, 1047A, and Options Floor Procedure Advice (“OFPA”) G-2, to: (i) provide that index options will open automatically following the receipt by the Exchange’s system of the opening price in the underlying index, and (ii) modify the circumstances authorizing the Exchange to halt trading in index options and to re-open trading of index options following a trading halt.

The text of the proposed rule change is available on the Exchange’s Web site at [http://www.phlx.com/regulatory/reg\\_rulefilings.aspx](http://www.phlx.com/regulatory/reg_rulefilings.aspx).

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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)(1).

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

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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The purpose of the proposed rule change is to eliminate the requirement that a specified minimum percentage of the underlying value of an index be open for trading in order for index options overlying such index to open for trading, and re-open following trading halts, in the Exchange's automated opening system<sup>5</sup> on its electronic trading platform for options, Phlx XL.<sup>6</sup> A further purpose of the proposed rule change is to amend Rule 1047A and OFPA G-2 to provide that it will no longer require a minimum percentage of the underlying value of an index to be halted in order for the Exchange to halt trading in options overlying the index, and that trading in a halted index option may be resumed upon a determination by an Options Exchange Official that the conditions which led to the halt are no longer present.

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<sup>5</sup> For a complete description of the Exchange's automated opening system, see Exchange Rule 1017. See also, Securities Exchange Act Release No. 52667 (October 25, 2005), 70 FR 65953 (November 1, 2005) (SR-Phlx-2005-25).

<sup>6</sup> See Securities Exchange Act Release No. 50100 (July 27, 2004), 69 FR 44612 (August 3, 2004) (SR-Phlx-2003-59).

## Background

Rule 1017 and the relevant sections of OFPA G-2 were initially adopted when the Exchange listed options overlying proprietary indices only. At the time, the Exchange's rules envisioned systemic calculations of the open for trading percentage of the underlying value of a particular proprietary index in order to determine whether options overlying such an index could open automatically under Exchange rules, and whether the specialist in such index options could elect to engage the system.

Values of non-proprietary indices underlying many of the options traded on the Exchange, such as options based on the KBW Bank Index, are currently calculated outside the NASDAQ OMX Group,<sup>7</sup> and the Exchange receives electronic price feeds from outside market data vendors ("vendors"). For such indices, the percentage of the underlying value that is open is generally not disseminated by the outside vendors. Moreover, while the information respecting index values and percentage of underlying value of proprietary indices may be accessible to Phlx XL participants,<sup>8</sup> it is not easily accessible to the general public.

The proposed elimination of the "percentage open" calculation from the Exchange's rules is intended to make rules governing the opening of index options on the Exchange consistent and transparent across both proprietary and non-proprietary indices. Specifically, the rules would provide that options overlying both types of indices would open automatically upon receipt of

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<sup>7</sup> The NASDAQ OMX Group has integrated internally the calculations of the legacy proprietary NASDAQ and legacy proprietary Phlx indices. All NASDAQ OMX Group indices are calculated using the same index "engine."

<sup>8</sup> The term "Phlx XL participant" means SQTs, RSQTs, non-SQT ROTs, specialists and non-Phlx market makers on another exchange; non-broker-dealer customers and non-market-maker off-floor broker-dealers; and Floor Brokers using the Options Floor Broker Management System. See Securities Exchange Act Release No. 58361 (August 14, 2008), 73 FR 49529 (August 21, 2008)(SR-Phlx-2008-50).

the opening price in the underlying index, regardless of what percentage of the index value is open for trading.

#### Pre-Opening Orders and Quotes

Exchange Rule 1017(a) currently states that, respecting index options, the Exchange will accept orders and quotes for a period of time before the scheduled opening in the underlying securities constituting 100% of the index value. The proposed rule change would amend Rule 1017(a) to eliminate the 100% benchmark, and instead state that in the case of index options, before the Exchange receives the opening price in the underlying index (and not less than one hour as determined by the Options Committee with notice to the membership via Exchange circular), Phlx XL will accept orders and quotes in index options during the “Pre-Opening Phase.”

Current Rule 1017(b) requires the specialist assigned in the particular option to enter opening quotes not later than one minute following the dissemination of a quote or trade by the market for the underlying security or, in the case of index options, following the dissemination of a quote or trade by the markets for underlying securities constituting 100% of the index value. The proposed rule change would provide that the specialist must enter such opening quotes following the receipt of the opening price of the underlying index.

Once the specialist submits such opening quotes, respecting index options the Phlx XL system will calculate an Anticipated Opening Price (“AOP”) and an Anticipated Opening Size (“AOS”), provided, under current rules, that (i) the Exchange has received market orders, or the book is crossed (highest bid is higher than the lowest offer) or locked (highest bid equals the lowest offer); and (ii) either (A) the specialist’s quote has been submitted; (B) the quotes of at least two Phlx XL participants have been submitted within two minutes opening trades or quotes

on the markets for underlying securities constituting 100% of the index value, or (C) if neither the specialist's quote nor the quotes of two Phlx XL participants have been submitted within two minutes of the opening trades or quotes on the markets for underlying securities constituting 100% of the index value, one Phlx XL participant has submitted their quote.

The proposed rule change would amend all of the above parameters in the rules for the calculation of an AOP and AOS respecting index options to base the time period on the receipt of the opening price in the underlying index (or such shorter time as determined by the Options Committee and disseminated to membership via Exchange Circular).

#### Opening

Current Exchange Rule 1017(b)(iii) provides that, respecting index options, when the conditions described are satisfied, the system will open the series for trading within a time period not to exceed 5 seconds (as determined by the Exchange and disseminated to membership via Exchange circular) following the dissemination of a quote or trade by the markets for underlying securities constituting 100% of the index value. The Exchange proposes to amend the rule to remove the “percentage open” calculation requirement and provide that the overlying index option would open when the Exchange has received the opening price in the underlying index.

Under the proposal, if there is an imbalance on the opening for an index option, the Phlx XL system will send an Imbalance Notice to Phlx XL participants provided that the Exchange has received the opening price in the underlying index.

Current Rule 1017(g) states that the specialist may engage the automated opening system to open index options when underlying securities representing 50% of the current index value of all the securities underlying the index have opened for trading on the markets and that the system will automatically open such options when underlying securities representing 100% of all the

securities underlying the index have opened for trading on the markets. The proposal would amend the rule to provide that index options will open automatically when the Exchange's system has received the opening price of the underlying index. The specialist would thus have no need to determine the percentage of underlying value that is open, since the index option would open automatically upon receipt by the system of the opening price in the underlying index.

The corresponding sections of Exchange Rule 1047A, and OFPA G-2 concerning the opening of index options will include the same language reflecting the manner in which index options would open under the proposal as stated above.<sup>9</sup>

#### Trading Halts and Re-Openings Following a Trading Halt

The Exchange is proposing additional amendments to Rule 1047A and OFPA G-2 to reflect the conditions under which the Exchange would halt trading in index options, and re-opening trading in index options following a trading halt. The purpose of this proposal is to reflect the deletion from the rule of the calculation of the percentage of an underlying index as discussed above, because current rules concerning trading halts in index options include a "percentage halted" requirement. In the same way that the rules concerning automated openings in index options system would no longer include the "percentage open" calculation requirement, Rule 1047A and OFPA G-2 would not include a "percentage halted" calculation requirement.

Specifically, Rule 1047A(c) and OFPA G-2(c) each state that whenever trading on the market in underlying securities representing more than 10% of the current index value is halted

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<sup>9</sup> The Exchange notes that Rule 1047A and OFPA G-2 refer to "Industry Index" and "Market Index" options. The Exchange represents that, respecting opening and re-opening of Industry and Market Index options, the Phlx XL system does not make a distinction between the two in terms of the current percentages of index value necessary for automatic openings. Therefore, such openings would take place on the Exchange uniformly among all index options traded on the Exchange.

or suspended on the primary market, trading on the Exchange in any option may be halted with the approval of an Options Exchange Official. For consistency, and because the proposal would eliminate the calculation of “percentage open” from the rules, the proposed rule change would eliminate the current “10% halted” requirement from Rule 1047A and OFPA G-2, and provide that trading on the Exchange in any index option may be halted with the approval of an Options Exchange Official, whenever trading on the primary market in any underlying security is halted or suspended.<sup>10</sup>

Additionally, Rule 1047A(c)(iv) and OFPA G-2(c)(iv) currently state that in the event that trading is halted on the primary market in underlying securities representing more than 10% of the current index value, the specialist may halt trading in the option overlying such index, subject to the approval of an Options Exchange Official within five minutes of the halt in trading in the option. The proposed rule change would account for the deletion of such a calculation requirement from the rule and provide that the specialist may take such action when trading on the primary market in any underlying security is halted.

Finally, respecting re-openings following a trading halt, Rule 1047A(d) and OFPA G-2(d) state that trading in any class or series of stock index options that has been the subject of a halt by the Exchange may be resumed upon a determination by an Options Exchange Official that the conditions which led to the halt are no longer present, or that underlying securities representing 50% or more of the current index value are not subject to halt or suspension in the market for the trading of such underlying securities. The proposed rule change would delete the “50%” provision because of the proposed elimination of all such calculations from the

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<sup>10</sup> The Exchange notes that it has deleted references to “primary market” regarding openings in options in a separate filing. See SR-Phlx-2008-75. The Exchange does not intend to delete such references from its rules governing trading halts

Exchange's rules. Under the proposal, such trading would resume upon a determination by an Options Exchange Official that the conditions which led to the halt are no longer present.

The Exchange believes that the proposed rule change is necessary to promote consistency and transparency concerning the automated opening of proprietary and non-proprietary index options on the Exchange.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>11</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>12</sup> 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 regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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; and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, or to regulate by virtue of any authority conferred by the Act title matters not related to the purposes of the Act or the administration of the Exchange.

The Exchange further believes that the proposed rule change should promote consistency and transparency respecting the opening of trading in all index options traded on the Exchange,

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<sup>11</sup> 15 U.S.C. 78f(b).

<sup>12</sup> 15 U.S.C. 78f(b)(5).



and also respecting trading halts and re-openings following trading halts, which would benefit customers and Phlx XL participants trading index options on the Exchange.

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

Because the foregoing rule does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; or (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 Act<sup>13</sup> and Rule 19b-4(f)(6) thereunder.<sup>14</sup>

At any time within 60 days of the filing of such 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.

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

<sup>14</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6)(iii) requires a self-regulatory organization to provide the Commission with written notice of its intent to file the 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 met this requirement.

#### 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 No. SR-Phlx-2008-74 on the subject line.

##### 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-2008-74. 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 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 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal

office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. SR-Phlx-2008-74 and should be submitted on or before [insert date 21 days from the date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>15</sup>

Florence E. Harmon  
Acting Secretary

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