

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-58691; File No. SR-Phlx-2008-69)

September 30, 2008

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the NASDAQ OMX PHLX, Inc. Relating to the Phlx XL Risk Monitor Mechanism

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 September 18, 2008, the NASDAQ OMX PHLX, Inc. (“Phlx” 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 Phlx. 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 Act³ and Rule 19b-4 thereunder,⁴ proposes to amend Exchange Rule 1093, Phlx XL Risk Monitor Mechanism, to reflect a system change to its fully electronic trading platform for options, Phlx XL.⁵ The system change would eliminate the current size offset of long calls vs. long puts and short calls vs. short puts in the accounts of Exchange Streaming Quote Traders (“SQTs”),⁶ Remote Streaming Quote Traders

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(1).

⁴ 17 CFR 240.19b-4.

⁵ See Securities Exchange Act Release No. 50100 (July 27, 2004), 69 FR 44612 (August 3, 2004) (SR-Phlx-2003-59). [sic].

⁶ An SQT is a Registered Options Trader (“ROT”) who has received permission from the Exchange to generate and submit option quotations electronically through an electronic interface with AUTOM via an Exchange approved proprietary electronic quoting device in eligible options to which such SQT is assigned. See Exchange Rule 1014(b)(ii)(A).

(“RSQTs”),⁷ non-SQT ROTs,⁸ and specialists (collectively, “Phlx XL participants”) when the Phlx XL system determines whether to engage the Risk Monitor Mechanism (as defined more fully below) by calculating the Net Offset Specified Engagement Size (as defined below).

The text of the proposed rule change is available on the Exchange’s Website at http://www.phlx.com/regulatory/reg_rulefilings.aspx.

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 provide Phlx XL participants with additional protection from the unreasonable risk associated with the execution of an excessive number of contracts resulting from near simultaneous executions in a single option issue.

⁷ An RSQT is an ROT that is a member or member organization with no physical trading floor presence who has received permission from the Exchange to generate and submit option quotations electronically through AUTOM in eligible options to which such RSQT has been assigned. An RSQT may only submit such quotations electronically from off the floor of the Exchange. See Exchange Rule 1014(b)(ii)(B).

⁸ A non-SQT ROT is an ROT who is neither an SQT nor an RSQT. See Exchange Rule 1014(b)(ii)(C).

Risk Monitor Mechanism

In January, 2006, the Exchange adopted Rule 1093 and deployed the Phlx XL Risk Monitor Mechanism.⁹ The Phlx XL Risk Monitor Mechanism is a component of Phlx XL that counts the number of contracts traded in a particular option by each Phlx XL participant within a specified time period established by each Phlx XL participant (the “specified time period”). The specified time period commences for an option when a transaction occurs in any series in such option. The specified time period may not exceed 15 seconds; Phlx XL participants may, however, set the specified time period for less than 15 seconds.

The system engages the Risk Monitor Mechanism in a particular option when the counting program has determined that a Phlx XL participant has traded a Specified Engagement Size (as defined below), as established by such Phlx XL participant, during the specified time period. When such Phlx XL participant has traded the Specified Engagement Size during the specified time period, the Risk Monitor Mechanism automatically removes such Phlx XL participant’s quotations from the Exchange’s disseminated quotation in all series of the particular option until such Phlx XL participant submits a new, revised quotation.

Specified Engagement Size

Each Phlx XL participant establishes a Specified Engagement Size for a particular option.¹⁰ When such Phlx XL participant has traded the Specified Engagement Size during the

⁹ See Securities Exchange Act Release No. 53166 (January 23, 2006), 71 FR 4625 (January 27, 2006)(SR-Phlx-2006-05).

¹⁰ A Phlx XL participant could establish the Specified Engagement Size as 100% or greater of the number of contracts executed in each series during the specified time period relative to the disseminated size. For example, a Phlx XL participant could establish the Specified Engagement Size as 200%, in which case the Risk Monitor Mechanism would not be engaged until 200% of the number of contracts in each series have been executed during the specified time period relative to the disseminated size. A Phlx XL participant could also establish the Specified Engagement Size as, for example, 120%, in which case

specified time period, the Risk Monitor Mechanism automatically removes such Phlx XL participant's quotations from the Exchange's disseminated quotation in all series of the particular option.

The Specified Engagement Size is determined as follows: For each series in an option, the counting program would determine the percentage that the number of contracts executed in that series represents relative to the disseminated size in that series (the "series percentage"). The counting program would then determine the sum of the series percentages in the underlying option issue (the "issue percentage"). Once the counting program determines that the issue percentage equals or exceeds a percentage established by the Phlx XL participant which may not be less than 100% (the "Specified Percentage"), the number of executed contracts in the option issue equals the Specified Engagement Size.

Offset on the Opposite Side of the Market

Currently, the Risk Monitor Mechanism calculates the number of contracts executed on one side of the market during the specified time period, and offsets that number of contracts by the number of contracts executed on the opposite side of the market during the specified time period. The purpose of this provision is to account for the offset in risk of one option position created by a position in the same option issue on the opposite side of the market. Because the risk in such a situation is generally neutral, the Exchange believes that Phlx XL participants should continue executing contracts until the actual risk that is created by the Specified Engagement Size is realized. The Specified Engagement Size is thus automatically offset by a

the Risk Monitor Mechanism would not be engaged until 120% of the number of contracts in each series have been executed during the specified time period relative to the disseminated size. In any event, however, a Phlx XL participant may not establish a Specified Engagement Size that is less than 100%.

number of contracts that are executed on the opposite side of the market in the same option issue during the specified time period (the “Net Offset Specified Engagement Size”).

Currently, the Risk Monitor Mechanism is engaged when the Net Offset Specified Engagement Size is for a number of contracts executed among all series during the specified time period that represents an issue percentage that is equal to or greater than the specified percentage. For example, currently a Phlx XL participant that buys calls and also sells calls or buys puts in the same option during the specified time period would have a Net Offset Specified Engagement Size as follows:

| <u>Series</u> | <u>Size</u> | <u>Buy call</u> | <u>Sell call/ buy put</u> | <u>Net offset size</u> | <u>Percentage</u> |
|-----------------|-------------|-----------------|-------------------------------|----------------------------|-------------------|
| Series 1 | 100 | 60 | 20 | 40 | 40% |
| Series 2 | 50 | 100 | 80 | 20 | 40% |
| Series 3 | 200 | 150 | 130 | 20 | 10% |
| <u>Series 4</u> | <u>150</u> | <u>75</u> | <u>60</u> | <u>15</u> | <u>10%</u> |
| Total | 500 | 385 | 290 | 95 | 100 |

In this example, 675 contracts have been executed during the specified time period (buy calls 385 + sell calls/buy puts 290). The Net Offset Specified Engagement Size for each series is determined by offsetting the number of contracts executed on the opposite side of the market for each series during the specified time period. The Risk Monitor Mechanism is engaged once the Net Offset Specified Engagement Size is executed for a net number of contracts among all series during the specified time period that represents an issue percentage that is equal to or greater than the specified percentage.

Proposed Amendment to Net Offset Specified Engagement Size

As stated above, the Specified Engagement Size is automatically offset by the Net Offset Specified Engagement Size. Currently, for example, a Phlx XL participant that buys calls and also sells calls or buys puts in the same option during the specified time period has a net Offset Specified Engagement Size that takes into account all opposite sides of the Phlx XL participants, including offset sizes respecting long call vs. long put positions, and short call vs. short put positions.

Long call and long put (and short call and short put) offsets ignore volatility risk associated with options. Since the inception and deployment on the Exchange of the Risk Monitor Mechanism, Phlx XL participants have experienced situations where the long call/long put offset and the short call/short put offset have unintentionally placed them at undue risk respecting market volatility.¹¹

Specifically, any long option position, whether a put or call, involves a positive volatility. Conversely, any short option position, whether a put or call, involves a negative volatility. Therefore, a Phlx XL participant's account that includes a long call position and a long put position in the same option will have a total positive volatility among the two positions. The two positions, when combined, do not offset one another respecting volatility. Instead, the two positions, when combined, result in the aggregate positive volatility of the two positions.

¹¹ While the sensitivity of an options price relative to change in the price of the underlying security is measured in "delta", the sensitivity of an options price relative to change in the volatility of the underlying security is measured in "vega". A relatively high vega in an options series means that the option has a relatively large extrinsic value (i.e., time premium of the option), thus affording more likelihood for the option premium price to deviate significantly, and a relatively low volatility means that the option has a relatively small extrinsic value, thus affording a smaller likelihood that the option price can change.

Similarly, any short option position, whether a put or call, involves a negative volatility. Therefore, a Phlx XL participant's account that includes a short call position and a short put position in the same option will have a total negative volatility among the two positions. The two positions, when combined, do not offset one another respecting volatility. Instead, the two positions, when combined, result in the aggregate negative volatility of the two positions.

Initially, the Exchange intended to offset opposite side positions when determining the Net Offset Specified Engagement Size because the delta (i.e., price change of the overlying option as a percentage of the price change in the underlying security) risk of each respective position was offset by the other. The Exchange did not, however, consider the aggregate volatility created by a long call/long put or short call/short put position. This combination results in a total aggregate volatility, and such volatility is not offset by the respective positions in the aggregate.

Accordingly, the Exchange proposes to eliminate the call/put offset provision from the Risk Monitor Mechanism and from the text of Rule 1093 in order to eliminate the undue volatility risk currently imposed on Phlx XL participants in this circumstance. The proposed rule change provides that long call positions will only be offset by short call positions (and vice versa), and long put positions will only be offset by short put positions. Eliminating the call/put offset provides greater protection for Phlx XL participants who seek to minimize their risk exposure when utilizing the Risk Monitor Mechanism. The Exchange believes that this protection should result in larger sized bids and offers made by Phlx XL participants, thus adding liquidity to the Exchange's markets while protecting Phlx XL participants from exposure to undue volatility risk respecting options positions.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act¹² in general, and furthers the objectives of Section 6(b)(5) of the Act¹³ 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 providing Phlx XL participants with additional protection from exposure to undue market risk through the Risk Monitor Mechanism.

The Exchange further believes that the proposed rule change is consistent with the Act because the risk protection afforded Phlx XL participants by way of elimination of the long put/call and short put/call offsets should encourage them to quote options series with greater size, adding liquidity to the Exchange's markets against which customers can trade.

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 proposed rule change effects a change in an existing order-entry or trading system that: (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) does not have the effect of limiting the access to or availability of the system, the proposed rule change has become

¹² 15 U.S.C. 78f(b).

¹³ 15 U.S.C. 78f(b)(5).

effective pursuant to Section 19(b)(3)(A) of the Act¹⁴ and subparagraph (f)(5) of Rule 19b-4 thereunder.¹⁵

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 the 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-Phlx-2008-69 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-2008-69. 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

¹⁴ 15 U.S.C. 78s(b)(3)(A).

¹⁵ 17 CFR 240.19b-4(f)(5).

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 such filing also will be available for inspection and copying at the principal office of 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-2008-69 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.¹⁶

Florence E. Harmon
Acting Secretary

¹⁶ 17 CFR 200.30-3(a)(12).