

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-63575; File No. SR-Phlx-2010-176)

December 17, 2010

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Notice of Filing of Proposed Rule Change Relating to Listing and Trading of Alpha 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 December 10, 2010, 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, pursuant to Section 19(b)(1) of the Act<sup>3</sup> and Rule 19b-4 thereunder,<sup>4</sup> proposes to amend certain of its rules to provide for the listing and trading of options on NASDAQ OMX Alpha Indexes<sup>SM</sup> (the "Alpha Indexes") on the Exchange's electronic trading platform for options, Phlx XL.<sup>5</sup>

The text of the proposed rule change is available on the Exchange's Website at <http://www.nasdaqtrader.com/micro.aspx?id=PHLXRulefilings>, at the principal office of the

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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.

<sup>5</sup> This proposal refers to "PHLX XL" as the Exchange's automated options trading system. In May 2009 the Exchange enhanced the system and adopted corresponding rules referring to the system as "Phlx XL II." See Securities Exchange Act Release No. 59995 (May 28, 2009), 74 FR 26750 (June 3, 2009) (SR-Phlx-2009-32).

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 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 permit the Exchange to list and trade cash-settled, European-style options on Alpha Indexes, a family of indexes developed by NASDAQ OMX Group, Inc. ("Nasdaq"). Alpha Indexes measure relative total returns of one underlying stock and one exchange traded fund share ("ETF") underlying options which are also traded on the Exchange (each such combination of two components is referred to as an "Alpha Pair").<sup>6</sup> Thus, an Alpha Index measures the relative total return of one stock and one ETF. The first component identified in an Alpha Pair (the "Target Component") is measured against the second component identified in the Alpha Pair (the "Benchmark Component").

At this time the Exchange is requesting Commission approval to list and trade Alpha Index options only on the following Alpha Pairs: AAPL/SPY, AMZN/SPY, CSCO/SPY, F/SPY, GE/SPY, GOOG /SPY, HPQ/SPY, IBM/SPY, INTC/SPY, KO/SPY, MRK/SPY, MSFT/SPY, ORCL/SPY, PFE/SPY, RIMM/SPY, T/SPY, TGT/SPY, VZ/SPY and WMT/SPY. The

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<sup>6</sup> Total return measures performance (rate of return) of price appreciation plus dividends over a given evaluation period.

Exchange will not list Alpha Index options on other Alpha Pairs without filing a proposed rule change seeking Commission approval for the listing and trading of any such additional Alpha Pairs.

### **Index Design and Calculation**

In order to calculate an Alpha Index, Nasdaq measures the total return performance of the Target Component relative to the total return performance of the Benchmark Component, based upon prices of transactions on the primary listing exchange of each underlying component. Any Target Component or Benchmark Component upon which an Alpha Index is based will meet the Exchange's listing standards and options overlying them will already be listed and traded on the Exchange. Each Alpha Index will initially be set at 100.00.

In order to calculate an Alpha Index, Nasdaq first calculates a daily total return for both the Target Component and the Benchmark Component of the Alpha Pair. For example, to calculate the daily total return today, the previous day's closing market price for the component would be subtracted from today's closing market price for the component to determine a price difference (the "Price Difference"). The Price Difference would be added to any declared dividend if today were an "ex-dividend" date to yield the Price Plus Dividend Difference for the component. The Price Plus Dividend Difference for the component is then divided by the previous trading day's closing market price for the component and the result is rounded, using simple rounding, to four decimal places to yield the total daily return.

The total daily return for each component is then added to the whole number one (e.g., 0.0156 plus 1 equals 1.0156) which permits the ultimate Alpha Index to be expressed in percentage terms. This figure for the Target Component is then divided by the comparable figure for the Benchmark Component, and then multiplied by previous trading day's closing

Alpha Index value. The resulting level depicts the Target Component's total return performance versus that of the previous trading day.

The following example illustrates the Alpha Index calculation for ABC stock as against SPY.<sup>7</sup>

Step 1.) For both ABC and SPY, the previous trading day's closing market price is subtracted from today's closing market price with the result added to any dividend declared today as the "ex-dividend" date. For example, today's closing price for ABC (214.01) minus the previous day's closing price (210.73) equals 3.28. Today is not an ex-dividend date for ABC; therefore, nothing is added to 3.28. Similarly, today's closing price for SPY (113.33) minus the previous trading day's closing price (111.44) equals 1.89. Today is not an ex-dividend date for SPY; therefore, nothing is added to 1.89.

Step 2.) The step one result is divided by the previous trading day's closing market price and the new result is rounded, using simple rounding, to four decimal places to yield the daily total return. For ABC, 3.28 would be divided by 210.73 to yield a daily total return of 0.0156. Similarly, for SPY, 1.89 would be divided by 111.44 and yield a daily total return of 0.0170.

Step 3.) The step two results above are added to the whole number one. For ABC, the daily total return of 0.0156 would be added to 1 for a result of 1.0156. For SPY the daily total return of 0.0170 would be added to 1 for a result of 1.0170.

Step 4.) In order to calculate the Alpha Index, the 1.0156 ABC figure is divided by the 1.0170 SPY figure and then multiplied by the previous trading day's closing Alpha Index value. Thus, assuming in the example that the previous trading day's closing Alpha Index value was

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<sup>7</sup> Daily total return values and Alpha Index values will be updated based upon prices of each reported transaction in the primary listing market. In the example below, closing prices are used simply for purposes of illustration.

100.00, today's closing Alpha Index value would be 99.86 ( $1.0156/1.0170 \times 100.00 = 99.86$ ). The 99.86 index level reflects that ABC's total return performance today versus yesterday was -.14% relative to SPY.

In the event of a corporate event which eliminates one of the underlying components of an Alpha Pair, Nasdaq will cease calculation of the Alpha Index for that Alpha Pair and all outstanding option positions will be immediately settled at the last disseminated price of that Alpha Index. In the event of a corporate event such as a spin off that affects the price of one of the underlying components, Nasdaq will make an appropriate one-time adjustment to the price of the underlying component used in the calculation to ensure that the Alpha Index continues to reflect the daily total return of the component.

Alpha Index values will be disseminated every second over the NASDAQ OMX Global Index Data Service (GIDS), which also disseminates the NASDAQ-100 index, the spot values for the PHLX currency options and the PHLX sector indexes.<sup>8</sup>

#### Listing Requirements

Alpha Index options will be listed only on Alpha Indexes comprised of Alpha Pairs that are actively traded. Rule 1009A, Designation of the Index, is being amended to provide that at the time of listing an Alpha Index option, options on each underlying component will also be listed and traded on the Exchange and will meet the requirements of Rule 1009, Criteria for Underlying Securities. Additionally, each underlying component's trading volume (in all markets in which the underlying security is traded) must have averaged at least 2,250,000 shares per day in the preceding twelve months. Following the listing of an Alpha Index option, options on each of the component securities of the Alpha Index must continue to meet the continued

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<sup>8</sup> See <http://www.nasdaqtrader.com/Trader.aspx?id=globalindexDS>.

listing standards set forth by Exchange Rule 1010, Withdrawal of Approval of Underlying Securities or Options. Additionally, each underlying component's trading volume (in all markets in which the underlying security is traded) must have averaged at least 2,000,000 shares per day in the preceding twelve months.

Finally, no Alpha Index option will be listed unless and until options overlying each of the Alpha Index component securities have been listed and traded on a national securities exchange with an average daily options trading volume during the three previous months of at least 10,000 contracts. Following the listing of an Alpha Index option, options on each of the component securities of the Alpha Index must continue to meet this options average daily volume standard.

#### Index Option Trading

Strike prices will be set to bracket Alpha Indexes in 1 point increments; thus, the interval between strike prices will be no less than \$1.00.<sup>9</sup> Phlx anticipates less volatility in Alpha Index options than in existing stock options. Additionally, options on components of an Alpha Pair may also have strikes with \$1.00 strikes. The Exchange therefore believes that \$1.00 strike intervals are appropriate for this product. The Exchange proposes to list series at \$1 or greater strike price intervals for each Alpha Index option, and to list at least two strike prices above and two strike prices below the current value of each Alpha Index option at about the time a series is opened for trading on the Exchange. The Exchange would also list additional strike prices at any price point, with a minimum of a \$1.00 interval between strike prices, as required to meet the needs of customers.

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<sup>9</sup> See Exchange Rule 1101A, Terms of Option Contracts, as proposed to be amended.

Under Phlx Rule 1033A, Meaning of Premium Bids and Offers, bids and offers in index options are to be expressed in terms of dollars and decimal equivalents of dollars per unit of the index (e.g., a bid of 5.50 would represent a bid of \$5.50 per unit). The minimum tick size for series trading below \$3 will be 0.05 and for series trading at or above \$3 the minimum tick will be 0.10; provided, however, that if options on either component of an Alpha Pair have a minimum tick size of 0.01, options on the Alpha Index will also have a minimum tick size of 0.01.<sup>10</sup>

Pursuant to Rule 1047A(c), trading in Alpha Index options may be halted with the approval of an Options Exchange Official, whenever trading on the primary market in one of the Alpha Pair components is halted or suspended. Additionally, trading shall be halted whenever an Options Exchange Official deems such action appropriate in the interests of a fair and orderly market and to protect investors. Rule 1047(c) is being amended to provide that the Exchange will also halt trading in the Alpha Index option whenever trading is halted in an option overlying one or both of the components of the Alpha Pair.<sup>11</sup> Finally, if Nasdaq should cease calculation of the Alpha Index due to a corporate event (such as a merger) affecting one or more components of the Alpha Pair, the Exchange will halt trading in the option and all open contracts will be immediately settled at the last Alpha Index price to be disseminated. Re-openings are conducted pursuant to Rule 1047(d), which is being amended so that it clearly applies to Alpha Indexes in addition to stock indexes.

Rule 1092, Obvious Errors and Catastrophic Errors, is being amended to provide that Alpha Index option trades on the Exchange will be nullified pursuant to Section (c)(iv)(C) of that rule if the trade occurred during a trading halt on the primary market in either component

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<sup>10</sup> See Exchange Rule 1034, Minimum Increments, as proposed to be amended.

<sup>11</sup> See Exchange Rule 1047A, Trading Rotations, Halts or Reopenings.

security of the Alpha Index. The word “percent” is added to the previous clause applicable to stock index options to correct an inadvertent omission in the existing rule text.

The Phlx will trade consecutive and cycle month series pursuant to Phlx Rule 1101A. Specifically, there will be at least two expiration months from the March, June, September, December cycle plus two additional near-term months so that the three nearest term months will always be available. The trading hours for options on the Alpha Indexes will be from 9:30 AM to 4:15 PM (Philadelphia Time).<sup>12</sup> Alpha Index options are index options that are available for FLEX trading.<sup>13</sup>

#### Exercise and Settlement

Options on any Alpha Index will expire on the Saturday following the third Friday of the expiration month. Trading in the expiring contract month will normally cease at 4:15 PM (Philadelphia Time) on the last day of trading. Exercise will result in delivery of cash on the business day following expiration. Alpha Index options will be A.M.-settled. The exercise settlement value will be based upon the opening prices of the individual stock or ETF from the primary listed market on the last trading day prior to expiration (usually a Friday).

The exercise settlement amount of an Alpha Index option will be equal to the difference between the exercise settlement value and the exercise price of the option, multiplied by \$100. When the last trading day is moved because of Exchange holidays, the last trading day for expiring options will be the day immediately preceding the last regularly-scheduled trading day.

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<sup>12</sup> See Exchange Rules 1101A, Terms of Option Contracts, Commentary .01, and 101, Hours of Business.

<sup>13</sup> See Exchange Rule 1079, FLEX Index, Equity and Currency Options, as proposed to be amended. The Exchange is proposing that separate position limits apply to FLEX Alpha Index options at the same levels applicable to non-FLEX Alpha Index options.



## Clearing

Alpha Index options are “Strategy Based Options” that will be cleared by the Options Clearing Corporation.

## Surveillance

The surveillance for opening price manipulation will be in place for the launch of options on Alpha Indexes and other existing surveillance patterns will be utilized to monitor trading in options on each Alpha Index. The Exchange represents that these surveillance procedures are adequate to monitor the trading of options on Alpha Indexes. For surveillance purposes, the Exchange will have complete access to information regarding trading activity in the pertinent underlying securities and options thereon.

## Position Limits

The Exchange is proposing that the position limit for an option on an Alpha Index shall be 60,000 contracts on the same side of the market. For purposes of determining compliance with position limits, positions in Alpha Index options will be aggregated with positions in equity options on the underlying securities.<sup>14</sup> All position limit hedge exemptions will apply. Section (a) of Commentary .01 to Rule 1001A, Position Limits, is being amended by the addition of clause (iii) providing that each Alpha Index option position to be exempted under the index hedge exemption must be hedged by a position in each of the component securities underlying the Alpha Index.

## Margin

The Exchange will set customer margin levels for Alpha Index options at the level of the higher of the margin required for options on the Target Component or the margin required for the

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<sup>14</sup> See Exchange Rule 1001A, Position Limits, as proposed to be amended.

Benchmark Component.<sup>15</sup>

#### Exchange Rules Applicable

Except as modified herein, the Exchange Rules 1000A—1107A, *Rules Applicable to Trading of Options on Indices*, will be applicable to Alpha Index options. The Exchange is proposing minor amendments to reflect trading of Alpha Index options which are not narrow-based or broad-based stock index options, which the Exchange currently trades, but rather strategy-based securities index options based upon an index whose construction and calculation differs from that of stock index options.

#### Systems Capacity

Additionally, the Exchange affirms that it possesses the necessary systems capacity to support new series that would result from the introduction of options on Alpha Indexes. The Exchange also has been informed that OPRA has the capacity to support such new series.

#### Customer Protection

Exchange rules designed to protect public customers trading in options would apply to Alpha Index options. Phlx Rule 1026 is designed to ensure that options, including Alpha Index options are sold only to customers capable of evaluating and bearing the risks associated with trading in the instruments. Phlx Rule 1024, applicable to the conduct of accounts, Phlx Rule 1025 relating to the supervision of accounts, Phlx Rule 1028 relating to confirmations, and Phlx Rule 1029 relating to delivery of options disclosure documents also would apply to trading in Alpha Index options.

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<sup>15</sup> See Exchange Rule 721, Proper and Adequate Margin, as proposed to be amended.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>16</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>17</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, in that it will permit trading in options based on Alpha Indexes pursuant to rules designed to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade, and thereby will provide investors with the ability to invest in options based on an additional index.

### 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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove the proposed rule change, or

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<sup>16</sup> 15 U.S.C. 78f(b).

<sup>17</sup> 15 U.S.C. 78f(b)(5).

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

#### 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-2010-176 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-Phlx-2010-176. 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.<sup>18</sup> 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-2010-176 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>19</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>18</sup> The text of the proposed rule change is available on the Commission's website at [www.sec.gov](http://www.sec.gov).

<sup>19</sup> 17 CFR 200.30-3(a)(12).