

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-63860; File No. SR-Phlx-2010-176)

February 7, 2011

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Order Granting Approval of Proposed Rule Change Relating to Listing and Trading of Alpha Index Options

I. Introduction

On December 10, 2010, NASDAQ OMX PHLX LLC (the “Exchange” or “Phlx”) filed with the Securities and Exchange Commission (the “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> a proposed rule change to amend certain of its rules to provide for the listing and trading of options on NASDAQ OMX (“Nasdaq”) Alpha Indexes<sup>SM</sup> (the “Alpha Indexes”) on the Exchange’s electronic trading platform for options. The proposed rule change was published for comment in the Federal Register on December 27, 2010.<sup>2</sup> The Commission received no comment letters on the proposed rule change. This order approves the proposed rule change.

II. Description

The Exchange proposes to list and trade cash-settled, European-style options on Alpha Indexes.

Index Design and Composition

Alpha Indexes measure relative total returns of one 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>3</sup> The first component identified in an

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

<sup>2</sup> See Securities Exchange Act Release No. 63575 (December 17, 2010), 75 FR 81320 (“Notice”).

<sup>3</sup> The total return measures performance (rate of return) of price appreciation plus dividends over a given evaluation period.

Alpha Pair (the “Target Component”) is measured against the second component identified in the Alpha Pair (the “Benchmark Component”).

The Exchange proposes 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 Exchange represents that it will not list Alpha Index options on any other Alpha Pairs without filing a proposed rule change seeking Commission approval.

#### Index 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. The Exchange has represented that 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. Further, the value of each Alpha Index will initially be set at 100.00.

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. To calculate the daily total return today, the previous trading 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 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, 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.

In the case 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 for that Alpha Pair will be immediately settled at the last disseminated price of that Alpha Index. In the case 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").<sup>4</sup>

#### Contract Specifications

The Exchange represents that Alpha Indexes are not broad-based or narrow-based indexes. Rather, they are strategy-based indexes that measure the relative total return of one stock and one ETF. Options on Alpha Indexes are European-style and A.M. cash-settled. The trading hours for options on the Alpha Indexes will be from 9:30 AM to 4:15 PM (Philadelphia Time).

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<sup>4</sup> See <http://www.nasdaqtrader.com/Trader.aspx?id=globalindexDS> for a description of the NASDAQ OMX Global Index Data Service.

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. Minimum strike price intervals for Alpha Index options would be at 1 point intervals. In addition, the minimum tick size for series of Alpha Index options trading below \$3 shall be \$0.05, and for series trading at or above \$3 shall be \$0.10.

#### 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 the listing of an Alpha Index option, options on each underlying component must also be listed and traded on the Exchange and must meet the requirements of Rule 1009, Criteria for Underlying Securities. Additionally, Rule 1009A is being amended to provide that 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. Further, 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 listing standards set forth by Exchange Rule 1010, Withdrawal of Approval of Underlying Securities or Options. Also, 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, Rule 1009A is being amended to provide that 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

The Exchange proposes to list series of Alpha Index options at \$1 or greater strike price intervals, 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.<sup>5</sup>

The Exchange may 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.<sup>6</sup>

Under Exchange 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. As proposed by the Exchange, the minimum tick size for series of Alpha Index options trading below \$3 will be \$0.05 and for series trading at or above \$3 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>7</sup>

Pursuant to Exchange 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 of one of the Alpha Pair components is halted or suspended. Additionally, Exchange Rule 1047A(c) provides that 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 1047A(c) is being amended to provide that the Exchange will also halt trading in any Alpha Index option whenever trading is halted in an option overlying one or both of the components of the Alpha

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<sup>5</sup> See Exchange Rule 1101A, Terms of Option Contracts, as proposed to be amended.

<sup>6</sup> See id.

<sup>7</sup> See Exchange Rule 1034, Minimum Increments, as proposed to be amended.

Pair.<sup>8</sup> Finally, the Exchange represents that 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 1047A(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 trades of Alpha Index options on the Exchange will be nullified pursuant to subsection (c)(iv)(C) of that rule if the trade occurred during a trading halt on the primary market of either component security of the Alpha Pair. The word “percent” is being added to the previous clause applicable to stock index options to correct an inadvertent omission in the existing rule text.

The Exchange will trade consecutive and cycle month series pursuant to Exchange Rule 1101A. Specifically, the Exchange represents that 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 Alpha Indexes will be from 9:30 AM to 4:15 PM (Philadelphia Time).<sup>9</sup> Alpha Index options are index options that are available for FLEX trading.<sup>10</sup>

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<sup>8</sup> See Exchange Rule 1047A, Trading Rotations, Halts or Reopenings, as proposed to be amended.

<sup>9</sup> See Exchange Rules 1101A, Terms of Option Contracts, Commentary .01, and 101, Hours of Business.

<sup>10</sup> See Exchange Rule 1079, FLEX Index, Equity and Currency Options, as proposed to be amended. The Exchange also proposes that separate position limits apply to FLEX Alpha Index options, which are the same as the position limits applicable to non-FLEX Alpha Index options.

### 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. Additionally, Alpha Index options will be A.M.-settled.<sup>11</sup> The exercise settlement value will be based upon the opening price of the individual stock or ETF from its primary listing market on the last trading day prior to expiration (usually a Friday).<sup>12</sup>

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.

### Position Limits

The Exchange proposes that the position limit for an option on an Alpha Index shall be 60,000 contracts on the same side of the market.<sup>13</sup> 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 is being amended by adding clause (iii), which provides 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.

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<sup>11</sup> See Exchange Rule 1009A, Designation of the Index, as proposed to be amended.

<sup>12</sup> See id.

<sup>13</sup> See Exchange Rule 1001A, Position Limits, as proposed to be amended.

<sup>14</sup> See id.

### 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 options on the Benchmark Component.<sup>15</sup>

### Exchange Rules Applicable

The Exchange represents that, except as modified in the proposed rule change, Exchange Rules 1000A—1107A, Rules Applicable to Trading of Options on Indices, will be applicable to Alpha Index options. The Exchange proposes minor amendments to reflect the trading of Alpha Index options, which are not the narrow-based or broad-based stock index options that the Exchange currently trades, but rather are strategy-based securities index options based upon an index whose construction and calculation differ from those of stock index options.

### Systems Capacity

The Exchange affirms that it possesses the necessary systems capacity to support any new series that would result from the introduction of options on Alpha Indexes. The Exchange also represents that it has been informed that the Options Price Reporting Authority (“OPRA”) has the capacity to support such new series.

### Clearing

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

### Surveillance

The Exchange represents that 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

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



utilized to monitor trading in options on each Alpha Index. The Exchange further represents that these surveillance procedures are adequate to monitor the trading of options on Alpha Indexes. For surveillance purposes, the Exchange represents that it will have complete access to information regarding trading activity in the pertinent underlying securities and options thereon.

#### Customer Protection

The Exchange represents that Exchange rules designed to protect public customers who trade in options would apply to Alpha Index options. Exchange 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. Exchange Rule 1024, applicable to the conduct of accounts, Exchange Rule 1025 relating to the supervision of accounts, Exchange Rule 1028 relating to confirmations, and Exchange Rule 1029 relating to delivery of options disclosure documents also would apply to trading in Alpha Index options.

### III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>16</sup> Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,<sup>17</sup> which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, 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.

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<sup>16</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation.

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

As a national securities exchange, the Phlx is required, under Section 6(b)(1) of the Act,<sup>18</sup> to enforce compliance by its members, and persons associated with its members, with the provisions of the Act, Commission rules and regulations thereunder, and its own rules. In addition, brokers that trade Alpha Index options will also be subject to best execution obligations and FINRA rules.<sup>19</sup> Applicable Exchange rules also require that customers receive appropriate disclosure before trading Alpha Index options.<sup>20</sup> Furthermore, brokers opening accounts and recommending options transactions must comply with relevant customer suitability standards.<sup>21</sup>

The trading of options on Alpha Indexes will be governed by Exchange Rules 1000A-1107A, the Exchange's trading rules for options on indices. The Commission believes that the listing rules proposed by the Exchange are consistent with the Act. The Commission also notes that Alpha Index options will be listed only on specified Alpha Indexes.<sup>22</sup> In addition, proposed changes to Rule 1009A requires that 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 and on a continuing basis must have averaged at least 2,000,000 shares per day in the preceding twelve months. The Commission believes that these requirements help to ensure that only highly liquid securities would underlie Alpha Indexes.

The Commission notes that the Exchange has represented that it will have appropriate surveillance procedures in place for trading in Alpha Index options. Opening price manipulation

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<sup>18</sup> 15 U.S.C. 78f(b)(1).

<sup>19</sup> See NASD Rule 2320.

<sup>20</sup> See Exchange Rule 1029.

<sup>21</sup> See Exchange Rule 1026. See also Exchange Rules 1024 and 1025.

<sup>22</sup> 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.

surveillance 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. In addition, for surveillance purposes, the Exchange will have complete access to information regarding trading activity in the pertinent underlying securities and options thereon. Further, the Commission believes that the Exchange's proposed position and exercise limits for the Alpha Index options are appropriate and consistent with the Act.

The Exchange has affirmed that it possesses the necessary systems capacity to support any new series that would result from the introduction of options on Alpha Indexes.<sup>23</sup> In addition, one point strike price intervals for Alpha Index options should provide investors with flexibility in the trading of Alpha Index options and further the public interest by allowing investors to establish positions that are better tailored to meet their investment objectives.

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<sup>23</sup> The Commission notes that Alpha Index values will be disseminated every second over the NASDAQ OMX Global Index Data Service.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>24</sup> that the proposed rule change (SR-Phlx-2010-176) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>25</sup>

Cathy H. Ahn  
Deputy Secretary

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<sup>24</sup> 15 U.S.C. 78s(b)(2).

<sup>25</sup> 17 CFR 200.30-3(a)(12).