

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-61326; File No. SR-Phlx-2009-113)

January 11, 2010

Self-Regulatory Organizations; NASDAQ OMX PHLX, Inc.; Notice of Filing of Proposed Rule Change by NASDAQ OMX PHLX, Inc. Relating to Index Option Position Limits

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 December 29, 2009, NASDAQ OMX PHLX, Inc. (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“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 Act³ and Rule 19b-4 thereunder,⁴ proposes to increase the position limits⁵ for certain narrow-based (industry) index option contracts.⁶ Phlx also proposes to amend Rule 1001A to delete obsolete references to index options which no longer trade on the Exchange, and to delete the word “Phlx” from the term “Phlx/KBW Bank Index”.

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 Position limits generally impose a ceiling on the number of option contracts in each class on the same side of the market (i.e., aggregating long calls and short puts or long puts and short calls) that can be held or written by an investor or group of investors acting in concert.

⁶ Also known as Sector Index Options.

The text of the proposed rule change is set forth below. Proposed new language is underlined and deleted language is bracketed.

Rule 1001A.

Position Limits

(a) Except as otherwise indicated, the position limit for a broad-based (market) index option shall be 25,000 contracts on the same side of the market. All other broad-based (market) index options contracts shall be subject to a contract limitation fixed by the Exchange, which shall not be larger than the limits provided in this section (a), except certain positions must be aggregated in accordance with paragraph (d) or (e) below:

[(i) Respecting the Value Line Composite Index, VLE, and the U.S. Top 100 Index, TPX, 75,000 contracts total, of which no more than 45,000 contracts can be in the nearest expiration month.

(ii) Respecting the National Over-the-Counter Index, XOC, 75,000 contracts total.

(iii) Respecting the Nasdaq Composite Index, (1) 50,000 contracts total for full-size options, with 30,000 contracts in the nearest expiration month, and (2) 500,000 contracts total for mini size options, with 300,000 contracts total in the nearest expiration month.]

(i[v]) Respecting the Full Value Russell 2000® Options and the Reduced Value Russell 2000® Options, there shall be no position limits.

(ii[v]) Respecting the Full Value Nasdaq 100 Options and the Reduced Value Nasdaq 100 Options, there shall be no position limits.

(b)(i) In determining compliance with Rule 1001, option contracts on a narrow-based (industry) index shall, subject to the procedures specified in subparagraph (iii) of this rule, be subject to the following position limits:

-- 18,000 contracts (or 54,000 contracts for options on the PHLX Oil Service Sector, PHLX Semiconductor Sector, PHLX Utility Sector, PHLX Gold/Silver Sector, PHLX Housing

Sector, SIG Energy MLP Index, SIG Oil Exploration & Production Index and the NASDAQ China Index) if the Exchange determines, at the time of a review conducted pursuant to subparagraph (ii) of this paragraph (b), that any single underlying stock accounted, on average, for 30% or more of the index value during the 30-day period immediately preceding the review; or

-- 24,000 contracts (or 72,000 contracts for options on the PHLX Oil Service Sector, PHLX Semiconductor Sector, PHLX Utility Sector, PHLX Gold/Silver Sector, PHLX Housing Sector, SIG Energy MLP Index, SIG Oil Exploration & Production Index and the NASDAQ China Index) if the Exchange determines, at the time of a review conducted pursuant to subparagraph (ii) of this paragraph (b), that any single underlying stock accounted, on average, for 20% or more of the index value or that any five underlying stocks together accounted, on average, for more than 50% of the index value, but that no single stock in the group accounted, on average, for 30% or more of the index value, during the 30-day period immediately preceding the review; or

-- 31,500 contracts (or 94,500 contracts for options on the PHLX Oil Service Sector, PHLX Semiconductor Sector, PHLX Utility Sector, PHLX Gold/Silver Sector, PHLX Housing Sector, SIG Energy MLP Index, SIG Oil Exploration & Production Index and the NASDAQ China Index)) if the Exchange determines that the conditions specified above which would require the establishment of a lower limit have not occurred, or

-- 44,000 contracts total with respect to the [Phlx/]KBW Bank Index.

(ii) - (iii) -- No Change.

(c) Reporting Requirements for Options on Market Indexes.—Each member or member organization that maintains a position on the same side of the market [in excess of 60,000

contracts for its own account or for the account of a customer in the Value Line Composite Index, VLE, and the U.S. Top 100 Index, TPX or the National Over-the-Counter Index, XOC, or] in excess of 100,000 contracts for its own account or for the account of a customer in the Full Value Russell 2000® Options, RUT; or in excess of 100,000 contracts for its own account or for the account of a customer in the Full Value Nasdaq 100 Options, NDX must file a report with the Exchange that includes, but is not limited to, data related to the option position, whether such position is hedged and if applicable, a description of the hedge and information concerning collateral used to carry the position. Registered Options Traders are exempt from this reporting requirement. For positions exceeding the position limit in paragraph (a), Commentary .01 contains the requirements for qualifying for the Index Hedge Exemption under this Rule.

(d) - (e) -- No Change.

Commentary -- No Change.

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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 increase index option position limits in Phlx Rule 1001A applicable to options on the PHLX Oil Service Sector, PHLX Semiconductor Sector, PHLX Utility Sector, PHLX Gold/Silver Sector, PHLX Housing Sector, SIG Energy MLP Index, SIG Oil Exploration & Production Index and the NASDAQ China Index) (collectively, the “Specified Index Options”) in order to attract additional trading interest and promote depth and liquidity in those options.⁷

Exchange exercise limits in Phlx Rule 1002A, Exercise Limits, which rule is not proposed to be amended, are established by reference to position limits. The proposed increase in position limits would therefore effectively also increase exercise limits.⁸

The Exchange believes that the current position limits constrain certain investors from trading the Specified Index Options, the markets for which have become well established and liquid. Pursuant to Rule 1001A, the three tiered levels of position limits are 18,000, 24,000, and 31,500 contracts. These position limits, which are similar among all the options exchanges respecting narrow-based index options, are based generally on the degree of concentration of a component stock of the index.⁹ In some cases the existing position limits for the Specified

⁷ The SIG Indexes noted herein are trademarks of SIG Indices, LLLP.

⁸ Phlx Rule 1002A, states, in relevant part: “. . . exercise limits for index options contracts shall be equivalent to the position limits described in Rule 1001A.”

⁹ Specifically, Phlx Rule 1001A(b)(i) currently provides the following position limits for narrow-based index options: (1) 18,000 contracts if the Exchange determines that any single underlying stock accounted, on average, for 30% or more of the index value during the 30-day period immediately preceding the semi-annual review of narrow-based index option position limits; (2) 24,000 contracts if the Exchange determines, at the time of a semi-annual review, that any single underlying stock accounted, on average, for 20% or more of the index value or that any five underlying stocks together accounted, on average, for more than 50% of the index value, but that no single stock in the group accounted, on average, for 30% or more of the index value, during the 30-day period immediately preceding the review; or (3) 31,500 contracts if the Exchange determines that the conditions specified above which would require the establishment of a lower

Index Options force these same investors out of transparent listed markets and into opaque over-the-counter (“OTC”) transactions. The Exchange proposes to increase these limits to 54,000, 72,000, and 94,500 contracts, respectively, for the Specified Index Options.

The Exchange recognizes that the purpose of position limits is to prevent manipulation and protect against disruption of the markets for both the option as well as the underlying security. The Exchange has considered the effects of increased position limits for the Specified Index Options on the marketplace, and believes that manipulation and disruption concerns are addressed by a combination of existing surveillances and the implementation of tiered position limits.

Increasing position limits for the Specified Index Options should increase market transparency to the benefit of the investing public by attracting more existing over the counter transactions in these securities to listed, centrally cleared markets. The Exchange dedicates substantial resources to monitoring the markets for evidence of manipulation or disruption caused by investors with positions at or near current position or exercise limits. The proposed increased position limits would not diminish the surveillance function in this regard. The Exchange believes an increase in position limits for the Specified Index Options at this time would reduce risk for manipulation and also benefit the investing public.

The proposed higher position limits for the Specified Index Options would serve to better accommodate the hedging needs of Exchange market makers and specialists, who are restricted by current position limit levels. Exchange members and customers have indicated that the current position limits hamper their ability to execute investment strategies in respect of narrow-

limit have not occurred. Additionally, the rule provides that position limits with respect to options on the KBW Bank Index are 44,000 contracts.

based indexes and have requested increased position limits. The market's need for these higher position limits is particularly critical for institutional hedging and other high volume trading objectives, and in view of the large portfolios common to institutional trading and the tendency to use larger-sized transactions to execute complex cross-market strategies. Floor members have also expressed the negative effect of the current low position limits on index options trading in an exchange environment. The Exchange believes, based on such member and customer requests, that the current position limit levels for the Specified Index Options continue to discourage market participation by large investors as well as institutions that compete to facilitate the trading interests of some of the largest investors. Accordingly, this proposal aims to also accommodate the liquidity and hedging needs of large investors and their facilitators.

Investors that are not able to take large positions in the Specified Index Options due to the restrictive index option position limits of Rule 1001A may resort in the alternative to executing that strategy in the OTC markets, where index option position limit rules do not constrain their ability to structure the desired strategy, and where regulators are limited in their ability to monitor and surveil market activity altogether. In today's evolving regulatory climate, the Exchange believes that the Commission should encourage migration of trading from opaque and largely unregulated OTC markets onto exchanges which are able to provide regulators with greater transparency and control. Additionally, by raising position limits, the Exchange should be able to increase investor participation in its markets for Specified Index Options, thereby reducing even further any potential for manipulation of index option settlement prices.

The Exchange understands based on conversations with Commission staff that the Commission's understanding of appropriate position limit levels is based upon an economic analysis of that issue conducted under the auspices of the Commission over five years ago (the

“SEC Study”).¹⁰ The Exchange understands that the goal of the SEC Study’s analysis was to determine a methodology for setting optimal position limits for index option contracts in order to minimize the potential for manipulation of the index options’ settlement prices. The Exchange also understands that SEC staff have recently reviewed the SEC’s study’s analysis to reflect changes in market and regulatory environment and have analyzed the Specified Index Options in light of its review.

Markets to buy and sell the individual index component stocks are now much more efficient, liquid, competitive and automated in nature making it highly unlikely that any one person or institution, either acting alone or in concert, could successfully influence the price of an underlying component stock to the extent that would be necessary to measurably affect the settlement price of one of the Specified Index Options. Since 2002, average daily volume has nearly tripled.¹¹ Furthermore, liquidity measures of the price impact of a trade show an improvement of tenfold or more relative to 2002 values. Finally, the stocks which are the individual index components of the Specified Index Options trade actively on a number of national market centers as well as OTC, and all major market centers have become highly automated and fully linked in response to Regulation NMS.

Finally, the Exchange is proposing to amend Rule 1001A to delete obsolete references to options on the Value Line Composite Index, the U.S. Top 100 Index and the National Over-the-

¹⁰ Exchange staff had previously discussed with Commission staff the issue of the position limits counseled by the SEC Study in the context of an earlier proposed rule change filed by the Exchange to raise the Sector Index option contracts’ position limits. That filing was ultimately withdrawn by the Exchange at Commission staff’s request. See SR-Phlx-2008-56.

¹¹ In 2002 United States equities markets averaged 77 billion shares traded per month. So far in 2009 United States equities markets are averaging 225 billion shares traded per month – nearly three times the trading volume of the 2002 markets.

Counter Index, as these index options are no longer traded on the Exchange, and is removing the word “Phlx” from the term Phlx/KBW Bank Index, as the index is now known simply as the “KBW Bank Index”.

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 establishing increased position limits for the Specified Index Options which should allow more efficient use of those options by market participants.

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 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date 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:

¹² 15 U.S.C. 78f(b).

¹³ 15 U.S.C. 78f(b)(5).

- (a) by order approve such proposed rule change, or
- (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. Please include File Number SR-Phlx-2009-113 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-2009-113. 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, 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. 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-2009-113 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.¹⁴

Florence E. Harmon
Deputy Secretary

¹⁴ 17 CFR 200.30-3(a)(12).