

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-54989; International Series Release No. 1299; File No. SR-Phlx-2006-34)

December 21, 2006

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing and Order Granting Accelerated Approval to Proposed Rule Change as Modified by Amendments No. 1, 2, and 3 Thereto Relating to U.S. Dollar-Settled Foreign Currency Options

I. Introduction

On May 12, 2006, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, as amended ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change relating to the listing and trading of U.S. dollar-settled foreign currency options ("FCOs") on the British pound and the Euro (together, the "Currencies"). On September 29, 2006, the Exchange filed Amendment No. 1,³ and on October 20, 2006, the Exchange filed Amendment No. 2.⁴ The proposed rule change, as amended, was published for comment in the Federal Register on November 2, 2006.⁵ The Commission received no comments on the proposal. On December 15, 2006, the Phlx filed Amendment No. 3 to the proposed rule change.⁶

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Form 19b-4 dated September 29, 2006 ("Amendment No. 1"). Amendment No. 1 replaced the original filing in its entirety.

⁴ See Form 19b-4 dated October 20, 2006 ("Amendment No. 2"). Amendment No. 2 replaced the Amendment No. 1 in its entirety.

⁵ See Securities Exchange Act Release No. 54652 (October 25, 2006), 71 FR 64597 ("Notice").

⁶ See Partial Amendment dated December 15, 2006 ("Amendment No. 3").

This order provides notice of the proposed rule change as modified by Amendments No. 1, 2, and 3 and approves the proposed rule change as amended on an accelerated basis.⁷

II. Description of the Proposal

The Exchange proposes to list U.S. dollar-settled FCOs⁸ on the Currencies and to adopt rules and rule amendments to permit the trading of U.S. dollar-settled FCOs on the Exchange's electronic trading platform for options, Phlx XL.⁹ The Exchange also proposes to amend a number of other rules applicable to U.S. dollar-settled FCOs, and to delete outdated references to the German mark, Italian lira, Spanish peseta, and the French franc.¹⁰

A. Contract Specifications and Amendments to FCO Rules

Background. U.S. dollar-settled FCOs are cash-settled, European-style options issued by The Options Clearing Corporation ("OCC") that allow holders to receive U.S. dollars representing the difference between the current foreign exchange spot price and the exercise price of the option. In contrast, a physical delivery option on a foreign currency, which the Exchange currently lists and trades, gives its owner the right to receive physical delivery (if it is a call) or to make physical delivery (if it is a put) of the underlying foreign currency when the

⁷ This order specifically approves the listing and trading of U.S. dollar-settled FCOs on the British pound and the Euro. The listing and trading of additional U.S. dollar-settled FCOs on other foreign currencies will require the Exchange to file additional proposed rule changes on Form 19b-4.

⁸ The Exchange previously traded U.S. dollar-settled options on the German mark and the Japanese yen beginning in September 1994 and February 1997, respectively. See Securities Exchange Act Release Nos. 33732 (March 8, 1994), 59 FR 12023 (March 15, 1994) and 36505 (November 22, 1995), 60 FR 61277 (November 29, 1995). U.S. dollar-settled German mark options and Japanese yen options were delisted on January 19, 1999 and August 23, 1999, respectively.

⁹ See Securities Exchange Act Release No. 49832 (June 8, 2004), 69 FR 33442 (June 15, 2004) (SR-Phlx-2003-59) (approving Phlx XL).

¹⁰ See Phlx Rules 722, 1000, 1001, 1009, 1014, 1033, 1034, 1069, 1079; and Options Floor Procedure Advice B-7.

option is exercised.¹¹ In addition, unlike other Phlx-traded FCOs, U.S. dollar-settled FCOs will be deemed to be exercised at expiration if the exercise settlement value is at least \$1.00 per contract unless the clearing member instructs OCC not to exercise it.¹²

Delivery and Payment. Upon exercise of an in-the-money U.S. dollar-settled FCO structured as a call, the holder would receive, from OCC, U.S. dollars representing the difference between the exercise strike price and the closing settlement value of the U.S. dollar-settled FCO contract multiplied by the number of units of currency covered by the contract. Similarly, for a U.S. dollar-settled FCO structured as a put, the holder would receive U.S. dollars representing the excess of the exercise price over the closing settlement value of the U.S. dollar-settled FCO contract multiplied by the number of units of foreign currency covered by the contract.¹³

Contract Size. The contract sizes of the U.S. dollar-settled FCO contracts on the Currencies would be 10,000 British pounds and 10,000 Euros.¹⁴

Expirations. The Exchange proposes to permit U.S. dollar-settled FCO contracts to be listed with expirations that are the same as the expirations permitted for equity index options pursuant to Phlx Rule 1101A, with the exception of long term option series and quarterly

¹¹ The Exchange has listed and traded physical delivery FCOs issued by OCC on a number of currencies since 1982. The Exchange's existing, physical delivery options on the Currencies would not be affected by this proposal and would continue to trade as they do today, by open outcry.

¹² However, the normal expiration date exercise procedures do not apply in circumstances in which the fixing of the exercise settlement amount is delayed beyond the last trading day before expiration. See OCC Rule 2302 (setting forth the expiration date exercise procedures), and Securities Exchange Act Release No. 54395 (December 13, 2006) (order approving SR-OCC-2006-10).

¹³ See Phlx Rule 1044.

¹⁴ The contract sizes for the physical delivery options on the Currencies are 31,250 British pounds and 62,500 Euros.

expiring FCOs which the Exchange does not propose to list.¹⁵ The Exchange anticipates that, at least initially, it would list expirations at one, two, three, six, and nine months, and that the options would be on three of the months from the March, June, September, December cycle, plus two additional near term months (five months at all times).¹⁶ The expiration date for the consecutive and cycle month options would be 11:59 p.m. Eastern Time on the Saturday immediately following the third Friday of the expiration month.¹⁷

Trading Hours. The Exchange proposes to trade U.S. dollar-settled FCOs from 9:30 a.m. to 4:00 p.m. Eastern Time, Monday through Friday.¹⁸ These trading hours differ from the trading hours for the physical delivery FCO contracts because the U.S. dollar-settled FCOs would, unlike the Exchange's physical delivery FCOs, trade on Phlx XL.¹⁹ An expiring U.S. dollar-settled FCO contract would cease trading at 4:00 p.m. on the day prior to its expiration day.²⁰ Unlike trading in physical delivery FCOs, trading in U.S. dollar-settled FCOs would not close on bank holidays.

¹⁵ See Phlx Rule 1012(a). The Exchange stated that it does not anticipate listing FLEX U.S. dollar-settled foreign currency options at this time. Currently, trades may be executed in certain FLEX options on equities and equity indexes. See Phlx Rule 1079.

¹⁶ By way of example, in September, the U.S. dollar-settled FCOs would have the following months listed: October, November, December, March, and June.

¹⁷ See Phlx Rule 1000(b)(21).

¹⁸ See Phlx Rule 101.

¹⁹ Trading hours for the Exchange's physical delivery FCO contracts are from 2:30 a.m. to 2:30 p.m. Eastern Time, Monday through Friday. Beginning December 1, 2006, the trading hours for physical delivery FCOs on the Exchange will be from 7:30 a.m. to 2:30 p.m. Eastern Time, Monday through Friday. See Securities Exchange Act Release No. 54802 (November 21, 2006), 71 FR 8875 (November 28, 2006) (Notice of Filing and Immediate Effectiveness of SR-Phlx-2006-72).

²⁰ The Exchange notes that in order to facilitate trading of the U.S. dollar-settled FCOs on Phlx XL, trading would be permitted to occur after the settlement value is announced on the day prior to expiration, as discussed below.

Settlement Values; Dissemination of Information. The closing settlement value would be the day's announced Noon Buying Rate,²¹ as determined by the Federal Reserve Bank of New York on the trading day prior to the expiration date.²² If the Noon Buying Rate is not announced by 2:00 p.m. Eastern Time, the closing settlement value would be the most recently announced Noon Buying Rate, unless the Exchange determines to apply an alternative closing settlement value as a result of extraordinary circumstances. The closing settlement value would not be disseminated through the Options Price Reporting Authority ("OPRA"), but would be posted on the Exchange's Web site, where it would be publicly available to all visitors to the Exchange's Web site on an equal basis, without the need to enter any kind of password. The Exchange has represented that it will not disclose the settlement value to any person or group of persons other than employees of the Exchange who need to know, prior to posting the value on the Exchange's Web site.

Position and Exercise Limits. For purposes of position and exercise limits, positions in U.S. dollar-settled FCO contracts would be aggregated with positions in the physical delivery contracts. In addition, position and exercise limits for the U.S. dollar-settled FCOs would be the same as the position and exercise limits for the physical delivery contracts pursuant to Phlx Rules 1001 and 1002. However, each Euro U.S. dollar-settled option contract would count as one-sixth of a contract for purposes of position and exercise limits.²³ Similarly, each British

²¹ See Securities Exchange Act Release No. 52843 (November 28, 2005), 70 FR 72486 (December 5, 2005) (order granting accelerated approval of SR-NYSE-2005-65).

²² See Phlx Rule 1057. If Friday is an Exchange holiday, the closing settlement value for U.S. dollar-settled FCOs would be determined on the basis of the Noon Buying Rate on the preceding trading day, which would also be the last day of trading for the expiring option.

²³ See Phlx Rule 1001. According to the Exchange, each U.S. dollar-settled Euro option contract would be treated as one-sixth of a contract for position and exercise limit

pound U.S. dollar-settled option contract would count as one-third of a contract for purposes of position and exercise limits.²⁴ The other aggregation principles in Phlx Rule 1001 would continue to apply.

Strike Prices. The Exchange proposes to initially list exercise strike prices for each expiration around the current spot price at half-cent (\$.005) intervals up to five percent on each side.²⁵ Thus, if the spot price initially were at 1.0000, the Exchange would list strikes in \$.005 intervals up to 1.0500 and down to .9500 for a total of twenty-one strike prices available for trading. The Exchange would not list any strike prices at intervals other than these \$.005 intervals.²⁶ As the spot price for U.S. dollar settled FCO moves, the Exchange would list new

purposes because the cash-settled Euro option contract is roughly one-sixth of the size of the physical delivery contract.

²⁴ The cash-settled British pound option contract is roughly one-third of the size of the physical delivery contract.

²⁵ According to the Exchange, the Exchange receives contributor bank quotes from a vendor in real-time and takes the average of the various quotes, to determine the foreign currency spot price.

²⁶ See proposed Commentary Section .06 to Phlx Rule 1012.

Strike prices would be expressed without reference to the first two decimal places. Minimum quoting increments and maximum quote spreads would also reflect this convention, as reflected in note 28, infra, and accompanying text.

For example, assuming that the actual spot value of the Euro is \$1.00, a strike could be listed at \$1.0050 and would be expressed as \$100.50. Similarly, the minimum quoting increment would be \$.0005 (expressed as \$.05), if the bid is less than \$.0300 (expressed as \$3.00), or \$.0010 (expressed as \$.10), if the bid equals or exceeds \$.0300 (expressed as \$3.00). Bids could be made at \$.0330 (expressed as \$3.30), at \$.0340 (expressed as \$3.40), and so forth. Offers could be made at \$.0350 (expressed as \$3.50), at \$.0360 (expressed as \$ 3.60), and so forth. Maximum quote spread parameters for bids and offers made in open outcry would range from \$.0025 (expressed as \$.25), to \$.0100 (expressed as \$1.00), depending upon the size of the prevailing bid. Thus, a market maker could bid \$.0330 (expressed as \$3.30) and offer \$.0370 (expressed as \$ 3.70). (Following open rotation, however, quotes may be made electronically with a difference not to exceed \$.0500 (expressed as \$5.00) between the bid and the offer regardless of the price of the bid). See Amendment No. 3, supra note 6, and infra note 28.

strike prices that, at the time of listing, do not exceed the spot price by more than 5% and are not less than the spot price by 5%. For example, if at the time of initial listing the spot price of the Euro is at 1.0000, the strike prices the Exchange would list would be .9500 to 1.0500. If the spot price then moves to 1.0500, the Exchange may list additional strikes at the following prices: 1.0550 to 1.1000. In that event, the Exchange would delist any previously-listed series outside of the current ten percent band that have no open interest. In addition, new strikes may be added during the life of the option in accordance with Phlx Rule 1012.²⁷

Bids and Offers – Premium. Under Phlx Rule 1033, bids and offers in U.S. dollar-settled FCOs on the Currencies must be made in terms of U.S. dollars per unit of the underlying foreign currency. The minimum increment for U.S. dollar-settled FCOs quoting under \$.0300 would be \$.0005 per unit of the foreign currency, expressed as .05 per unit of the foreign currency, which equals a \$5.00 minimum increment per contract consisting of 10,000 Euros or 10,000 British pounds. The minimum increment for U.S. dollar-settled FCOs quoting at \$.0300 or higher would be \$.0010 per unit of the foreign currency, expressed as .10 per unit of the foreign currency, which equals a \$10.00 minimum increment per contract consisting of 10,000 Euros or 10,000 British pounds.²⁸

Prior to commencement of trading of U.S. dollar-settled options on the Currencies, the Exchange intends to issue an informational memorandum to members and member organizations which explains this strike price and quoting convention.

²⁷ See Phlx 1012(a)(iv).

²⁸ See Phlx Rule 1034(a). By way of example, if the spot price of the Euro is at \$1.2550 and an investor purchases the December Euro \$1.2500 (expressed as \$125.00) Call at a premium of \$.0075 (expressed as \$.75) and then sells the December Euro \$1.2500 Call at a premium of \$.0095 (expressed as \$.95), the investor's profit would be \$.0020 per Euro. The investor's total profit would be \$.0020 per Euro multiplied by 10,000 Euros (the size of the contract) for a total of \$20.00. Amendment No. 3 corrected a technical error in the use of the quoting convention in Phlx Rule 1034(a). Amendment No. 3 also revised an example in note 23 of the Notice to: (1) reflect that the minimum increment when the bid equals or exceeds \$.0300 (expressed as \$3.00) is \$.0010 (expressed as 10 cents), not

Margin Requirements. The U.S. dollar-settled FCOs would have the same customer margin requirements as are provided for the existing FCOs pursuant to Phlx Rule 722, Commentary .16.²⁹ The Exchange calculates the margin requirements for each foreign currency underlying U.S. dollar-settled FCO separately, rather than determining one margin level for all foreign currencies based upon the historical pricing information for all foreign currencies together. The Exchange informs members and the public of the margin levels for each currency option immediately following the quarterly reviews described in Phlx Rule 722, Commentary .16.

\$.0005 (expressed as 5 cents), as the example erroneously implied as originally drafted, (2) reduce the size of the bid in the example from an unrealistic \$1.00 (expressed as \$100.00) range to a more realistic \$.0300 (expressed as \$3.00) range while continuing to illustrate the same underlying concepts, and (3) note that the maximum quote spread parameters do vary depending on the size of the prevailing bid and whether the bid/offer is made on Phlx XL as opposed to open outcry. See Amendment No. 3, supra note 6.

²⁹ Pursuant to Phlx Rule 722, Commentary .16, the Exchange calculates the margin requirement for customers that assume short FCO positions by adding a percentage of the current market value of the underlying foreign currency contract to the option premium price less an adjustment for the out-of-the-money amount of the option contract. On a quarterly calendar basis, the Exchange reviews five-day price changes over the preceding three-year period for each underlying currency and sets the add-on percentage at a level which would have covered those price changes at least 97.5% of the time (the "confidence level"). If the results of subsequent reviews show that the current margin level provides a confidence level below 97%, the Exchange increases the margin requirement for that individual currency up to a 98% confidence level. If the confidence level is between 97% and 97.5%, the margin level would remain the same but would be subject to monthly follow-up reviews until the confidence level exceeds 97.5% for two consecutive months. If during the course of the monthly follow-up reviews, the confidence level drops below 97%, the margin level is increased to a 98% level and if it exceeds 97.5% for two consecutive months, the currency is taken off monthly reviews and is put back on the quarterly review cycle. If the currency exceeds 98.5%, the margin level is reduced to a 98% confidence level during the most recent three year period. Finally, in order to account for large price movements outside the established margin level, if the quarterly review shows that the currency had a price movement, either positive or negative, greater than two times the margin level during the most recent three year period, the margin requirement is set at a level to meet a 99% confidence level.

B. Surveillance

The Phlx will integrate U.S. dollar-settled FCOs into existing Phlx market surveillance programs for equity and index options, as well as for physical delivery foreign currency options, and intends to apply those same program procedures to the U.S. dollar-settled FCOs. The Exchange represents that these surveillance programs for U.S. dollar-settled FCOs will be adequate to monitor exchange trading of U.S. dollar settled FCOs and detect violation of exchange rules, thereby deterring manipulation.³⁰

Futures on the British pound and the Euro, as well as options on such futures are traded on the Chicago Mercantile Exchange ("CME") (both exchange pit trading and GLOBEX trading). Euro Currency Trust Shares and British Pound Sterling Shares trade on the New York Stock Exchange ("NYSE") and on NYSE Arca. The Exchange represented that, to the best of the Exchange's knowledge, these U.S. markets are the primary trading markets in the world for exchange-traded futures, options on futures and trust shares on these currencies. The Exchange also represented that it may obtain trading information via the Intermarket Surveillance Group ("ISG") from other exchanges who are members or affiliates of the ISG. Specifically, the Phlx can obtain such information from the NYSE and NYSE Arca in connection with shares of the Euro Currency Trust and the CurrencySharesTM British Pound Sterling Trust trading on the NYSE and NYSE Arca, and from the CME and London International Financial Futures Exchange ("LIFFE") in connection with Euro and Pound futures trading on those exchanges.³¹

In addition, the Phlx represented that it is able to obtain information regarding trading in the Euro Currency Trust Shares, British Pound Sterling Shares, Euro and British Pound options,

³⁰ See Amendment No. 3, supra notes 6 and 28.

³¹ NYSE and NYSE Arca are members of ISG. CME and LIFFE are affiliate members of ISG.

and Euro and British Pound futures and options on futures through Phlx members, in connection with such members' proprietary or customer trades which they effect on any relevant market.³² Pursuant to Phlx Rule 1022, specialists and Registered Options Traders ("ROTs") are required to identify all accounts maintained for foreign currency trading in which the specialist or ROT engages in trading activity or over which he exercises investment discretion, and no specialist or ROT may engage in foreign currency trading in any account not reported pursuant to the rule. Phlx Rule 1022 also requires every specialist and ROT to make available to the Phlx upon request all books, records and other information relating to transactions for their own account or accounts of associated persons with respect to the foreign currency underlying U.S. dollar-settled FCOs, including transactions in the cash market as well as the futures, options and options on futures markets. An amendment to Phlx Rule 1022(d) would also add transactions in "other foreign currency derivatives" to the list of currency related transactions with respect to which specialists and ROTs must provide information to the Exchange.

C. Trading on Phlx XL

The Exchange proposes that U.S. dollar-settled FCOs trade on Phlx XL, the Exchange's electronic trading platform for options. In this regard, the Exchange proposes to amend a number of rules that currently govern the trading of equity and equity index options that trade as "Streaming Quote Options" on Phlx XL to extend the coverage of those rules to U.S. dollar-settled FCOs and to include U.S. dollar-settled FCOs as a product that may be traded on Phlx XL as a Streaming Quote Option.³³ Exchange specialists, on-floor market makers known as

³² See Equity Floor Procedure Advice F-8 and Options Floor Procedure F-8, Failure to Comply with an Exchange Inquiry.

³³ See Phlx Rule 1080.

Streaming Quote Traders ("SQTs"),³⁴ and remote market makers known as Remote Streaming Quote Traders ("RSQTs")³⁵ who stream their U.S. dollar-settled FCO quotes to the Exchange would be eligible to participate in the directed order flow program. Specialists in U.S. dollar-settled FCOs, like specialists in equity and equity index options, also would be eligible to participate in the Exchange's enhanced specialist participation programs.³⁶

Obligations and Restrictions. U.S. dollar-settled FCOs would trade in the same general manner as equity index options,³⁷ which are also U.S. dollar-settled products.³⁸ In this regard, Phlx Rule 1014 is being amended to make clear that the obligations and restrictions applicable to specialists and ROTs trading equity index options now generally would apply to specialists and ROTs in U.S. dollar-settled FCOs.³⁹ In addition, under the amendments to Phlx Rule 1014, specialists and ROTs in U.S. dollar-settled FCOs, like specialists in physical delivery FCOs,

³⁴ See Phlx Rule 1014(b)(ii)(A).

³⁵ See Phlx Rule 1014(b)(ii)(B).

³⁶ The Exchange currently has several Enhanced Specialist Participation programs, embodied in Phlx Rule 1014(g). These programs establish specified percentages as the Enhanced Specialist Participation, depending on the category of option. Currently, the specialist in physical delivery FCOs is not entitled to a "specialist enhancement," although such a program was once in effect.

³⁷ However, Phlx Rule 1080, Commentary .01, is being revised to reflect that the Auto-Quote system applies to equity and equity index options, but not to U.S. dollar-settled FCOs. The Exchange's Auto-Quote system incorporates pricing model data, which generate automatic pricing of option series based on a number of factors, including the value of the underlying stock.

³⁸ See Phlx Rules 1014 and 1080. Conforming changes are being made to Options Floor Procedure Advices B-6, Priority of Options Orders for Equity Options and Index Options by Account Type, B-7, Time Priority of Bids/Offeres in Foreign Currency Options, and F-6, Option Quote Parameters.

³⁹ However, Phlx Rule 1014(c)(i)(B), which provides for a maximum option price change with exceptions based upon the price of the underlying security, would not apply to U.S. dollar-settled FCOs. The Exchange does not have a maximum option price change rule that applies to physical delivery FCOs and is not proposing a maximum option price change rule for U.S. dollar-settled FCOs.

would be subject to rules relating to bid/ask differentials and other affirmative market making obligations and restrictions⁴⁰ but those rules with respect to U.S. dollar-settled FCOs would track rules currently applicable to equity options, in order to facilitate trading on the Phlx XL system by the system's current users who are accustomed to the existing bid/ask differentials applicable to equity options.⁴¹

In addition, the Exchange proposes to amend Phlx Rule 1063 and Options Floor Procedure Advice C-2 to provide that the Floor Broker Management System currently employed with respect to equity and equity index options would also be required to be used for U.S. dollar-settled FCOs.⁴²

Openings. Phlx Rule 1017 governs the Exchange's fully automated opening system for options traded on Phlx XL.⁴³ Phlx Rule 1017 is being amended to reflect that U.S. dollar-settled

⁴⁰ However, Phlx Rule 1014(c)(i)(B), which provides for a maximum option price change with exceptions based upon the price of the underlying security, would not apply to U.S. dollar-settled FCOs.

⁴¹ Other amendments to Phlx Rule 1014 would make clear that current provisions on priority/parity and bid/ask differentials that apply to FCO contracts would be limited to physical delivery FCOs. See paragraphs (c)(ii) and (h), and Commentary .16 of Phlx Rule 1014. Similarly, options Floor Procedure Advice F-17, relating to trades to be effected in the trading pit, is being amended so that it applies only to physical delivery FCOs, because U.S. dollar-settled FCOs will trade on Phlx XL.

⁴² The Options Floor Broker Management System is a component of AUTOM designed to enable Floor Brokers and/or their employees to enter, route and report transactions stemming from options orders received on the Exchange. The Options Floor Broker Management System also is designed to establish an electronic audit trail for options orders represented and executed by Floor Brokers on the Exchange. See Phlx Rule 1080, Commentary .06.

⁴³ For a description of the automated opening system, see Securities Exchange Act Release Nos. 52667 (October 25, 2005), 70 FR 65953 (November 1, 2005) (SR-Phlx-2005-25), and 53242 (February 7, 2006), 71 FR 7604 (February 13, 2006) (SR-Phlx-2006-11). The Exchange also is making a technical change to clarify the application of Phlx Rule 1017 to index options by inserting reference to "underlying securities constituting 100% of the index value." The rule currently refers to the opening of the "underlying security," which makes sense with respect to equity options, but not index options.

FCOs would be opened using the automated opening system, subject to certain adjustments to current processes because FCO openings, unlike openings of equity and index options, would not depend upon the opening of trading in an underlying cash market.⁴⁴ More specifically, Phlx Rule 1017 would provide that Phlx XL would accept orders and quotes in U.S. dollar-settled FCOs beginning no later than one hour before market opening, and that the specialist assigned in the particular U.S. dollar-settled FCO must enter opening quotes not later than 30 seconds after market opening.⁴⁵ It would provide that in certain circumstances an anticipated opening price would be calculated if the quotes of at least two Phlx XL participants have been submitted within two minutes of market opening (or such shorter time as determined by the FCO Committee and disseminated to membership via Exchange circular). Finally, it would provide that the system would not open a series of U.S. dollar-settled FCOs if the opening price is not within an acceptable range (as determined by the FCO Committee and announced to Exchange members and member organizations by way of Exchange circular).

Block Trades. In addition, the block trade procedures in Phlx Rule 1016 are limited to physical delivery FCOs. According to the Exchange, the block trading rule currently enables market participants to execute large-size FCO orders in an orderly fashion at a price that may not be the best bid or offer for that particular FCO, but is the best price available for executing a block trade in such FCO. To take advantage of the block execution procedure, Phlx Rule 1016 requires a floor broker with a block order to quote the market in a particular FCO, announce that a block quotation for a specified number of contracts over 1,000 is sought, and ascertain from the trading crowd the best price at which the entire order can be executed. The Exchange believes

⁴⁴ See Phlx Rule 1017. In addition, the Exchange is making conforming changes to Options Floor Procedure Advices A-12 and A-14.

⁴⁵ Market opening, as with equity and equity index options, is normally at 9:30 a.m. Eastern Time.

that trading of U.S. dollar-settled FCOs on Phlx XL by SQTs and RSQTs who stream quotes into the system makes execution of block trades pursuant to the procedures required by Phlx Rule 1016 impractical.

Customized Foreign Currency Options. Phlx Rule 1069 is being amended to limit the applicability of the rule to physical delivery FCOs so that U.S. dollar-settled FCOs would not be eligible to trade on a customized basis.

Foreign Currency Options Committee. Phlx Rules 1014 and 1080 and Options Floor Procedure Advice A-13 is being amended to provide that the Foreign Currency Options Committee would have decision-making authority in certain instances with respect to U.S. dollar-settled FCOs (rather than the Options Committee, which oversees the trading of equity and equity index options on Phlx XL). In addition, the Phlx is deleting the words "on-floor" from the term "on-floor Governor" in Phlx Rule 1014(g), because the "on-floor Governor" category has previously been eliminated from the Exchange's by-laws.⁴⁶

D. Customer Protection

Exchange rules designed to protect public customers trading in FCOs would apply to U.S. dollar-settled FCOs on the Currencies. Specifically, Phlx Rule 1024(b) prohibits members from accepting a customer order to purchase or write a U.S. dollar-settled FCO unless such customer's account has been specially approved in writing by a designated Foreign Currency Options Principal of the member for transactions in FCOs. Additionally, Phlx Rule 1026 is designed to ensure that options, including U.S. dollar-settled FCOs, are sold only to customers capable of evaluating and bearing the risks associated with trading in the instruments. Finally, under Phlx Rule 1027, members are permitted to exercise discretionary power with respect to

⁴⁶ See Amendment No. 3, supra notes 6 and 28.

trading U.S. dollar-settled FCOs in a customer's account only if the member has received prior written authorization from the customer and the account has been accepted in writing by a designated Foreign Currency Options Principal. In addition, the Foreign Currency Options Principal or a Registered Options Principal must approve and initial each discretionary U.S. dollar-settled FCO on the day the order is entered.⁴⁷ 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 U.S. dollar-settled FCOs.

III. Commission Finding and Conclusions

After careful consideration, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁴⁸ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,⁴⁹ which requires that an exchange have rules designed, among other things, 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.

A. Settlement Value and Dissemination of Information

The Commission believes that sufficient venues exist for obtaining reliable information on the Currencies so that investors in U.S. dollar-settled FCOs can monitor the underlying spot market in the Currencies. The Commission also believes that the Phlx's procedures and the competitive nature of the spot market for the Currencies should help to ensure that the settlement

⁴⁷ See Phlx Rule 1027.

⁴⁸ In approving this rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁴⁹ 15 U.S.C. 78f(b)(5).

values for U.S. dollar-settled FCO contracts will accurately reflect the spot price for foreign currencies. Finally, the closing settlement value, which will be the Noon Buying Rate on the trading day prior to expiration,⁵⁰ would be posted on the Exchange's Web site, where it would be publicly available to all visitors on an equal basis, without the need to enter any kind of password.

B. Customer Protection

The Commission believes that a regulatory system designed to protect public customers must be in place before the trading of sophisticated financial instruments, such as U.S. dollar-settled FCOs on the Currencies, can commence on a national securities exchange. The Commission believes this goal has been satisfied by the application of Phlx customer protection rules for FCOs to U.S. dollar-settled FCOs.

C. Surveillance

The Commission notes that the Phlx will integrate U.S. dollar-settled FCOs into existing Phlx market surveillance market programs for equity and index options, as well as for physical delivery foreign currency options, and that the Phlx intends to apply those same program procedures to the U.S. dollar-settled FCOs. The Commission also notes that Phlx Rule 1022, Equity Floor Procedure Advice F-8, and Options Floor Procedure F-8, as amended to include transactions in "other foreign currency derivatives," provide Phlx with the authority to obtain information regarding trading in the Euro Currency Trust Shares, British Pound Sterling Shares, Euro and British Pound options, and Euro and British Pound futures and options on futures through Phlx members, in connection with such members' proprietary or customer trades which

⁵⁰ If the Noon Buying Rate is not announced by 2:00 p.m. Eastern Time, the closing settlement value would be the most recently announced Noon Buying Rate, unless the Exchange determines to apply an alternative closing settlement value as a result of extraordinary circumstances.

they effect on any relevant market. In addition, the Phlx may obtain trading information via the ISG from other exchanges who are members or affiliates of the ISG. Specifically, the Phlx can obtain such information from the NYSE and NYSE Arca in connection with shares of the Euro Currency Trust and the CurrencySharesTM British Pound Sterling Trust trading on the NYSE and NYSE Arca, and from the CME and LIFFE in connection with Euro and Pound futures trading on those exchanges. The Commission believes that these rules provide the Phlx with the tools necessary to adequately surveil trading in the Securities.

D. Position and Exercise Limits

As noted above, U.S. dollar-settled FCO contracts will be aggregated with physical delivery contracts for position and exercise limit purposes. The Commission believes that aggregation of U.S. dollar-settled FCOs with the physical delivery contracts for position and exercise limit purposes is prudent and minimizes concerns regarding manipulations or disruptions of the markets for U.S. dollar-settled FCO contracts and physical delivery contracts.

E. Trading on Phlx XL

The Commission believes that the trading of U.S. dollar-settled FCOs on Phlx XL is consistent with the Act. The rules that currently govern the trading of equity and equity index options that trade as "Streaming Quote Options" on Phlx would be extended to include U.S. dollar-settled FCOs.⁵¹

F. Other Rules

The Commission believes that the other rule changes proposed by the Phlx to accommodate the trading of U.S. dollar-settled FCOs are consistent with the Act. First, the Commission believes it is reasonable for the Phlx to initially list exercise strike prices for each

⁵¹ See supra notes 33 to 42 and accompanying text.

expiration around the current spot price at half-cent (\$0.005) intervals up to five percent on each side.⁵² The Commission notes that the Phlx has represented that it has the system capacity to support the additional quotations and messages that will result from listing options on U.S. dollar settled FCOs.⁵³

Finally, the Commission believes that it is consistent with the Act for the Exchange to establish the minimum trading increment for U.S. dollar-settled FCOs at \$.0005 (expressed as \$.05) per unit of the foreign currency for U.S. dollar-settled FCOs quoted at less than \$.0300 (expressed as \$3.00), and at \$.0010 (expressed as \$.10) per unit of the foreign currency for U.S. dollar-settled FCOs quoted at \$.0300 (expressed as \$3.00) or higher.

G. Accelerated Approval

Pursuant to Section 19(b)(2) of the Act, the Commission finds good cause to approve the proposal, as amended, prior to the thirtieth day after the amended proposal is published for comment in the Federal Register. Amendment No. 3 clarifies the proposed rule change with respect to the Phlx quoting convention, deletes outdated references to "on-floor Governor" in Phlx Rule 1014, and contains Phlx representations with regard to the Phlx surveillance procedures. Accordingly, the Commission finds good cause to accelerate approval of the amended proposal prior to the thirtieth day after publication in the Federal Register.

⁵² When listing additional strikes, the Commission expects the Exchange to consider whether the listing of such strikes will be consistent with the maintenance of a fair and orderly market.

⁵³ See Letter, dated October 11, 2006, from Thomas A. Whitman, Senior Vice President, Phlx, to Elizabeth King, Associate Director, Division of Market Regulation ("Division"), Commission, Heather Seidel, Senior Special Counsel, Division, Commission, and David Hsu, Special Counsel, Division, Commission.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 3, including whether Amendment No. 3 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-2006-34 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-Phlx-2006-34. 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. 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-2006-34 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁵⁴ that the proposed rule change (SR-Phlx-2006-34), as modified by Amendments No. 1, 2, and 3, be, and it hereby is, approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁵⁵

Florence E. Harmon
Deputy Secretary

⁵⁴ 15 U.S.C. 78s(b)(2).

⁵⁵ 17 CFR 200.30-3(a)(12).