

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-58949; File No. SR-Phlx-2008-79)

November 14, 2008

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by NASDAQ OMX PHLX, Inc. Relating to Reducing the Exposure Time for Option Limit Orders to One Second

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 November 10, 2008, NASDAQ OMX PHLX, Inc. (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “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 Act<sup>3</sup> and Rule 19b-4 thereunder,<sup>4</sup> proposes to amend Exchange Rule 1080(c) to provide that: (i) Order Entry Firms<sup>5</sup> may not execute as principal against orders on the limit order book they represent as agent unless such agency orders are first exposed on the limit order book for at least one (1) second, or the Order Entry Firm has been bidding or offering on the Exchange for

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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> The term “Order Entry Firm” means a member organization of the Exchange that is able to route orders to the Exchange’s AUTOM system. See Exchange Rule 1080(c)(ii)(A)(1).

at least one (1) second prior to receiving an agency order that is executable against such order, and (ii) Order Entry Firms must expose orders they represent as agent for at least one (1) second before such orders may be automatically executed, in whole or in part, against orders solicited from members and non-member broker-dealers to transact with such orders.

The text of the proposed rule change is available on the Exchange's Website at [http://www.phlx.com/regulatory/reg\\_rulefilings.aspx](http://www.phlx.com/regulatory/reg_rulefilings.aspx).

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of the proposed rule change is to reduce the exposure time during which Order Entry Firms may not execute as principal against orders they represent as agent while continuing to afford the opportunity for other market participants to execute at or better than the limit order price during such exposure period.

Rules 1080(c)(ii)(C)(1) and (2) currently provide that an Order Entry Firm may not execute as principal against orders on the limit order book they represent as agent unless: (a) agency orders are first exposed on the limit order book for at least three

seconds, (b) the Order Entry Firm has been bidding or offering on the Exchange for at least three (3) seconds prior to receiving an agency order that is executable against such order, or (c) the Order Entry Firm proceeds in accordance with the crossing rules contained in Rule 1064.<sup>6</sup>

In addition, Order Entry Firms must expose orders they represent as agent for at least three (3) seconds before such orders may be automatically executed, in whole or in part, against orders solicited from members and non-member broker-dealers to transact with such orders. Under the proposal, these exposure periods would be reduced to one second.

The Exchange adopted the 3-second exposure period in August, 2006, in response to similar functionality already in existence on other options exchanges.<sup>7</sup> The Exchange notes that in adopting the three-second order handling and exposure period, it recognized that three seconds would not be long enough to allow human interaction with the orders. Rather, market participants had become sufficiently automated that they could react to these orders electronically. In this context, the Exchange believes it would be in all market participants' best interest to minimize the exposure period to a time frame that

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<sup>6</sup> Exchange Rule 1064 states, in relevant part: "An Options Floor Broker who holds orders to buy and sell the same option series may cross such orders, provided that he proceeds in the following manner: (i) In accordance with his responsibilities for due diligence, pursuant to Rule 155, an Options Floor Broker shall request bids and offers for such options series and make all persons in the trading crowd aware of his request. (ii) After providing an opportunity for such bids and offers to be made, he must bid and offer at prices differing by the minimum increment and must improve the market by bidding above the highest bid or offering below the lowest offer. (iii) If such higher bid or lower offer is not taken, he may cross the orders at such higher bid or lower offer by announcing by public outcry that he is crossing and giving the quantity and price."

<sup>7</sup> See Securities Exchange Act Release No. 54298 (August 9, 2006), 71 FR 47282 (August 16, 2006)(SR-Phlx-2006-41).

continues to allow adequate time for market participants to respond electronically, as both the order being exposed and the participants responding are subject to market risk during the exposure period. In this respect, the Exchange states that its experience with the three-second exposure time period indicates that one second would provide an adequate response time. The Exchange does not believe it is necessary or beneficial to the orders being exposed to continue to subject them to market risk for a full three seconds.

The Exchange has numerous market participants that have the capability and do opt to respond within a one-second exposure period on the Exchange's fully automated trading platform for options, Phlx XL.<sup>8</sup> Recently, the Exchange distributed a survey to members that regularly participate in orders executed on Phlx XL that would be affected by the proposal. To substantiate that its members could receive, process, and communicate a response back to the Exchange within one second, the survey asked members to identify how many milliseconds it took for (i) a broadcast from the Exchange to reach their systems; (ii) their systems to generate responses; and (iii) their responses to reach the Exchange. The survey results indicate that the time it takes a message to travel between the Exchange and its members is not more than 100 milliseconds each way. The survey also indicated that it typically takes not more than 50 milliseconds for member systems to process the information and generate a response. Thus, the survey indicated that it typically takes not more than 250 milliseconds for members to receive, process, and respond to broadcast messages related to the various Mechanisms. Additionally, all

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<sup>8</sup> See Securities Exchange Act Release No. 50100 (July 27, 2004), 69 FR 44612 (August 3, 2004) (SR-Phlx-2003-59).

8 members that responded to the survey indicated that reducing the exposure period to one second would not impair their ability to participate in orders affected by the proposal. The Exchange believes that this information provides additional support for its assertion that reducing the exposure periods from three seconds to one second will continue to provide members with sufficient time to ensure effective interaction with orders.

The Exchange is submitting the instant proposal in order to remain competitive with other exchanges that have reduced the exposure period from 3 seconds to 1 second.<sup>9</sup> The Exchange believes that reducing its order handling and exposure periods from three seconds to one second will benefit market participants. The Exchange further believes that reducing the time periods to one second will allow it to provide investors and other market participants with more timely executions, thereby reducing market risk.<sup>10</sup>

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>11</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>12</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, by providing

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<sup>9</sup> See Securities Exchange Act Release Nos. 57849 (May 22, 2008), 73 FR 31167 (May 30, 2008)(SR-CBOE-2008-16); and 58224 (July 25, 2008), 73 FR 44303 (July 30, 2008) (SR-ISE-2007-94).

<sup>10</sup> The Exchange believes that the proposed timeframe would give market participants sufficient time to respond, compete, and provide price improvement for orders. The Exchange also notes that electronic systems are readily available to, if not already in place for, Exchange members that allow them to respond in a meaningful way within the proposed timeframe.

<sup>11</sup> 15 U.S.C. 78f(b).

<sup>12</sup> 15 U.S.C. 78f(b)(5).

investors with more timely execution of their options orders, while ensuring that there is an adequate exposure of limit orders in the Exchange's marketplace.

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 Phlx consents, the Commission will:

(A) by order approve such proposed rule change, or

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

The Exchange has requested accelerated approval of this proposed rule change prior to the 30<sup>th</sup> day after the date of publication of the notice in the Federal Register.

The Commission is considering granting accelerated approval of the proposed rule change at the end of a 15-day comment period.

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-2008-79 on the subject line.

Paper comments:

- Send paper comments in triplicate to Florence E. Harmon, Acting Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-Phlx-2008-79. 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 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-2008-79 and should be submitted on or before [insert date 15 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>13</sup>

Florence E. Harmon  
Acting Secretary

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<sup>13</sup> 17 CFR 200.30-3(a)(12).