

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-67976; File No. SR-Phlx-2012-105)

October 4, 2012

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Order Approving Proposed Rule Change, as Modified by Amendment No. 1 Thereto, Regarding Treasury Securities Options

I. Introduction

On August 7, 2012, NASDAQ OMX PHLX LLC (“Exchange” or “Phlx”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to adopt new rules in the Exchange’s 1000D Series to permit the listing and trading of options on Treasury securities. The proposed rule change was published for comment in the Federal Register on August 23, 2012.³ On September 25, 2012, the Exchange filed Amendment No. 1 to the proposed rule change.⁴ The Commission received no comments on the proposal. This order approves the proposed rule change, as modified by Amendment No. 1 thereto.

II. Description of the Proposal

The Exchange proposes to adopt rules that would, in conjunction with current applicable Exchange rules and procedures, permit the listing and trading of options on Treasury securities.⁵

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 67683 (August 17, 2012), 77 FR 51088 (August 23, 2012) (“Notice”).

⁴ In Amendment No. 1, the Exchange proposed minor wording changes to substitute the phrase “options listing timeframe” for the certain other phrases throughout the rule text and Exhibit 1. Amendment No. 1 is technical in nature, and therefore the Commission is not publishing Amendment No. 1 for public comment.

⁵ Subsection (a)(1) of proposed Rule 1001D defines the term “Treasury security” as a bond or note or other evidence of indebtedness that is a direct obligation of, or an obligation guaranteed as to principal or interest by, the United States or a corporation in which the

The Exchange intends to list and trade standardized options on two specific types of marketable on-the-run Treasury securities: notes and bonds. Treasury securities options will be designated by reference to the issuer of the underlying Treasury security, principal amount, expiration month (and year for the longest term option series), exercise price, type (put or call), stated rate of interest, and stated date of maturity or nominal term to maturity.

Pricing and Transparency. Treasury securities are initially sold in a scheduled auction process and thereafter trade in a secondary market. The Exchange asserts that the prices of Treasury securities are widely disseminated, active, and visible to traders and investors. In addition, the Exchange represents that it intends to obtain real-time Treasury prices from a market data provider so that it can use these data in support of the Exchange's market, regulatory, and surveillance operations, as well as for opening and determining settlement values for Treasury options. The Exchange has represented that, 30 days prior to the start of trading Treasury security options, it will make an announcement, via an Options Trader Alert, to its member organizations regarding the details of the proposed real-time Treasury price offering. The Exchange has represented that, on the basis of the real-time Treasury data that the Exchange is able to get, it may offer an alternative Treasury data feed to Exchange members that may desire to acquire such data from the Exchange.

The Exchange would list options only on on-the-run Treasury securities. The Exchange believes that these securities are extremely liquid and afford excellent price discovery because

United States has a direct or indirect interest (except debt securities guaranteed as to timely payment of principal and interest by the Government National Mortgage Association). Securities issued or guaranteed by individual departments or agencies of the United States are sometimes referred to by the title of the department or agency involved (e.g., a "Treasury security" is a debt instrument that is issued by the U.S. Treasury).

on-the-run (as opposed to off-the-run) Treasury securities are the most recently issued U.S. Treasury bonds or notes and are the most frequently traded securities of a maturity. Further, the Exchange notes that on-the-run Treasury securities are readily quoted and offered by numerous public sources and broker-dealers, and that prices are also available from exchanges that trade derivatives on Treasuries.

Trading Rules. Treasury securities options will trade on the Exchange's electronic options platform, Phlx XL,⁶ and settle like equity options on the Exchange. Exchange rules applicable to equity options trading generally will be applicable to Treasury securities options unless a specific rule in the 1000D Series is to the contrary or supplements an existing rule. Trading hours will correspond to the hours during which equity options are normally traded on the Exchange, which currently are 9:30 a.m. to 4:00 p.m. ET.

Terms and Criteria for Listing and Trading. Treasury securities may be initially approved by the Exchange as underlying securities for Exchange transactions in specific CUSIP options, subject to requirements as to size of original issuance (the original public sale of an underlying Treasury security must be at least \$1 billion in principle), aggregate principal amount outstanding, and years to maturity. Additionally, approval will extend only to the settled, on-the-run Treasury securities.⁷ The Exchange will not approve a subsequent on-the-run Treasury

⁶ See Securities Exchange Act Release No. 59995 (May 28, 2009), 74 FR 26750 (June 3, 2009) (SR-Phlx-2009-32) (order approving Phlx XL II).

⁷ See Phlx Rule 1006D. The proposal is designed to ensure that a Treasury security is eligible for underlying options only during its most liquid on-the run period. Options on a newly settled (subsequent) on-the-run Treasury security can be listed only after all the options that are listed pursuant to the preceding options listing timeframe expire. This minimizes or negates overlap and proliferation of Treasury options. An on-the run Treasury security in the options listing timeframe becomes off-the-run when there is a subsequent auction for the Treasury security and as a result the newly settled security becomes on-the-run. The Exchange will not list options on the subsequent on-the-run Treasury security until

security until after the expiration of all the options that are listed pursuant to this described options listing timeframe.

The expiration month and exercise price of each series will be determined by the Exchange at the time that the series is first opened for trading. The Exchange will open a minimum of one expiration month and series for each class of options. The Exchange may open and add Treasury options in one or all of the months in the options listing timeframe. Treasury security options opened for trading on the Exchange will expire on a monthly basis.

Minimum Price Variation. Treasury securities options will have a minimum increment of \$0.01.⁸ The Exchange asserts that the proposed \$0.01 increment is appropriate for Treasury securities options to allow traders to make the most effective use of the product for hedging purposes. The Exchange also represents that the proposed \$0.01 increments will not cause any capacity problems.

Series Open for Trading. The Exchange proposes that the exercise price of each series of Treasury security options will be fixed at a price denominated in \$0.50 increments. The exercise price will be reasonably close to, and no more than 20% away from, the price at which the underlying security is traded in the primary market at the time the series of options is first opened for trading.

Settlement. Treasury securities options will be physically settled, European-style options that may be exercised only on the day that they expire. Trading in Treasury securities options ordinarily will cease on the business day (usually a Friday) preceding the expiration date. The expiration date will be the Saturday immediately following the third Friday of the expiration

all options listed within the options listing timeframe on the immediately preceding on-the-run Treasury security (which has become off-the-run) expire.

⁸ See Phlx Rule 1013D.

month. The settlement process for Treasury securities options will be the same as the settlement process for equity options under current Exchange rules (e.g., Phlx Rule 1044). Payment of the aggregate exercise price must be accompanied by payment of accrued interest on the underlying Treasury security.

Additional information relating to options on Treasury securities – including definitions, listing standards, expiration, exercise, settlement, margin rules, positions limits, doing business with the public, and surveillance – can be found in the Notice.

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁹ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,¹⁰ which requires that the rules of an exchange be designed, among other things, to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, to remove impediments to and to perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest. The Commission believes that the proposal appropriately balances, on the one hand, the Exchange's desire to offer a new product to investors with, on the other hand, the necessity of having appropriate rules for listing, trading and margin, among other

⁹ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁰ 15 U.S.C. 78f(b)(5).

considerations relevant under the Act. The Commission notes that it has previously approved similar rules permitting other options exchanges to list and trade options on Treasury securities.¹¹

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹² that the proposed rule change (SR-Phlx-2012-105), as modified by Amendment No. 1 thereto, be, and it hereby is, approved.

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

Kevin M. O'Neill
Deputy Secretary

¹¹ See Chicago Board Options Exchange (“CBOE”) rules 21.1-21.31. See also Securities Exchange Act Release No. 18371 (December 23, 1981), 46 FR 63423 (December 31, 1981) (approving SR-Amex-81-1 and SR-CBOE-81-27).

¹² 15 U.S.C. 78s(b)(2).

¹³ 17 CFR 200.30-3(a)(12).