

MEMORANDUM #0358-08
RC-2007-68
Release No. 34-57265

MEMORANDUM

TO: Members and Member Organizations

FROM: Legal Department

DATE: February 20, 2008

RE: FLEX® U.S. Dollar-Settled Foreign Currency Options

The Securities and Exchange Commission has approved proposed rule change SR-Phlx-2007-68 which provides for the listing and trading of FLEX® U.S. dollar-settled foreign currency options. The proposed rule change amends Rule 1079, FLEX® Index and Equity Options, to accommodate trading of U.S. dollar-settled FCOs with individually tailored expiration dates and exercise prices ("FLEX® currency options"). Provisions of Rule 1079 that are not limited by their terms to FLEX® index or equity options will be equally applicable to FLEX® currency options. Generally, like FLEX® index and equity options, FLEX® currency options will be traded in accordance with many existing options rules. Rule 1079 states that to the extent that the provisions of Rule 1079 are inconsistent with other applicable Exchange rules, Rule 1079 takes precedence with respect to FLEX® options.

Pursuant to proposed Rule 1079(a)(3)(C), users will be able to individually tailor the strike prices of FLEX® currency options. Strike prices need not be consistent with strike price intervals permissible for non-FLEX® U.S. dollar-settled FCOs. The strike price may be specified in terms of a specific dollar amount rounded to the nearest ten thousandth of a dollar (expressed without reference to the first two decimal places) for FLEX® currency options other than the Japanese yen currency option. FLEX® options on the Japanese yen may be specified in terms of a specific dollar amount rounded to the nearest one millionth of a dollar (expressed without reference to the first four decimal places).

Pursuant to proposed Rule 1079(a)(6), FLEX® currency option contracts will be allowed to expire on any month, business day and year within two years, provided that a FLEX® currency option will not be permitted to expire on any day that falls on or within two business days prior or subsequent to an expiration day for a non-FLEX® U.S. dollar-settled FCO on the same underlying currency or on any day on which the Federal Reserve Bank is not scheduled to publish its Noon Buying Rate. All FLEX® currency options with customized expiration dates will expire at 11:59 p.m. eastern time on their designated expiration date and cease trading at 10:15 a.m. eastern time that day.

FLEX® currency options will be quoted in terms of dollars per unit of underlying foreign currency, like the non-FLEX® U.S. dollar settled FCOs. FLEX® currency options may be quoted and traded in the same minimum increments that are established for non-FLEX® U.S. dollar settled FCOs. FLEX® currency options, like non-FLEX® U.S. dollar-settled FCOs, will be limited to European exercise style only.

Rule 1079(a)(9) is amended to provide for settlement for FLEX® currency options. The settlement value determination for FLEX® currency options generally will be the same as for non-FLEX® U.S. dollar-settled FCOs, except that the closing settlement value for FLEX® currency options will be the Noon Buying Rate on the expiration date, whereas Rule 1057 bases the closing settlement value for non-FLEX® U.S. dollar-settled FCO on the Noon Buying Rate on the business day prior to expiration. FLEX® currency options will be subject to the exercise-by-exception procedures of OCC.

The Phlx XL trading system is not available for FLEX® options. All FLEX® options must be quoted and traded in the trading crowd of the corresponding non-FLEX® option. Quoting and trading in FLEX® currency options will be subject to Rule 1079(b), which currently governs the quoting and trading of FLEX® index and equity options. Rule 1079(c), which governs who may trade FLEX® options, will apply to FLEX® currency options in the same manner as FLEX® index and equity options. In addition, crossing in FLEX® currency options will be governed by Rule 1079(b)(6), which currently applies to crosses in FLEX® index and equity options.

Pursuant to proposed Rule 1079(a)(8), if there is no open interest in the particular FLEX® currency option series when a request for a quote ("RFQ") is submitted, the minimum size of an RFQ for FLEX® currency options will be 50 contracts. If there is open interest, the minimum size of the RFQ will be 25 contracts, or the remaining size on a closing transaction, whichever is less. The minimum value size for a responsive quote, other than a responsive quote of an assigned Registered Options Trader ("ROT") or assigned Specialist, will be 50 contracts or the remaining size on a closing transaction, whichever is less. Assigned ROTs and assigned Specialists who respond to an RFQ will be required to respond to each RFQ with at least 250 contracts or the size amount requested in the RFQ, whichever is less.

Proposed Rule 1079(d)(3) is unique to FLEX® currency options and provides that positions in FLEX® currency options will be aggregated with positions in non-FLEX®

U.S. dollar-settled FCO contracts, as well as physical delivery FCO contracts, for purposes of determining compliance with the position limits established by Phlx Rule 1001.

The Exchange has determined that, initially, FLEX® currency options will have the same trading hours as non-FLEX® U.S. dollar-settled FCOs. The Exchange will be able to establish other trading times for FLEX® currency options within the regular trading hours for the non-FLEX® U.S. dollar-settled FCOs, including reflecting any new trading hours for non-FLEX® U.S. dollar-settled FCOs.

Amendments to Rule 1079 and Options Floor Procedure Advice F-28 are set forth below.

New language is underlined; deletions are bracketed.

Rule 1079. FLEX® Index, [and] Equity and Currency Options

A Requesting Member shall obtain quotes and execute trades in certain non-listed FLEX® options at the specialist post of the non-FLEX® option on the Exchange. The term "FLEX® option" means a FLEX® option contract that is traded subject to this Rule. Although FLEX® options are generally subject to the rules in this section, to the extent that the provisions of this Rule are inconsistent with other applicable Exchange rules, this Rule takes precedence with respect to FLEX® options.

(a) Characteristics:

(1) Underlying [security] interest --

(A) any index upon which options currently trade on the Exchange. The applicable index multiplier shall be the same multiplier, in the case of U.S. dollar-denominated FLEX® index options, that applies to non-FLEX® index options on the same underlying index; [or]

(B) any security which is options-eligible pursuant to Rule 1009; or

(C) any foreign currency which is options-eligible pursuant to Rule 1009 and which underlies non-FLEX® U.S. dollar-settled foreign currency options that are trading on the Exchange.

(2) [No Change]

(3) Exercise price --

(A) with respect to FLEX® index options, may be specified in terms of a specific index value number, a percentage of the index value calculated as of the open or close of trading on the Exchange on the trade date, or a method for fixing such number; [or]

(B) with respect to FLEX® equity options, may be specified in terms of a specific dollar amount rounded to the nearest \$.10 or a percentage of the underlying security rounded to the nearest minimum increment; or

(C) with respect to FLEX® currency options other than Japanese yen options, may be specified in terms of a specific dollar amount rounded to the nearest ten thousandth of a dollar (expressed without reference to the first two decimal places), and with respect to FLEX® currency options on the Japanese yen, may be specified in terms of a specific dollar amount rounded to the nearest one millionth of a dollar (expressed without reference to the first four decimal places).

(4) Quote format --

(A) in the case of FLEX® index options and equity options, a bid and/or offer in the form of a decimal price (e.g. .10 or .25), pursuant to Rule 1034, a specific dollar amount, or a percentage of the underlying equivalent value, in the case of FLEX® index options, or security, in the case of FLEX® equity options, rounded to the nearest minimum increment; or

(B) in the case of FLEX® currency options, in the form of dollars per unit of underlying foreign currency in the minimum increments set forth for U.S. dollar settled foreign currency options in Rule 1034(a)

(5) Exercise style --American or European in the case of FLEX® index options and FLEX® equity options, and European only in the case of FLEX® U. S. dollar-settled foreign currency options;

(6) Expiration date --

(A) any month, business day and year within five years for FLEX® index options and within two years for FLEX® currency options, except that (i) a FLEX® option may not expire on any day that falls on or within two business days prior or subsequent to an expiration day for a non-FLEX® option on the same underlying index (except quarterly expiring index options) or underlying currency, (ii) the expiration date for FLEX® currency options may not fall on a date on which the Federal Reserve Bank of New York is not scheduled to publish a Noon Buying Rate, and (iii) all FLEX® currency options will expire at 11:59 p.m. eastern time on their designated expiration date; or

(B) - (C) No Change.

(7) No Change.

(8) Minimum size --

(A) **Opening** --If there is no open interest in the particular series when an RFQ is submitted, the minimum size of an RFQ is:

(i) \$10 million underlying equivalent value, respecting FLEX® market index options, and \$5 million underlying equivalent value respecting FLEX® industry index options; [and]

(ii) the lesser of 250 contracts or the number of contracts having \$1 million of underlying equivalent value, with respect to FLEX® equity options; and

(iii) 50 contracts in the case of FLEX® currency options.

(B) **Opened** --If there is open interest, the minimum size of an RFQ is:

(i) respecting FLEX® index options, \$1 million underlying equivalent value, or the remaining size on a closing transaction, whichever is less; [or]

(ii) respecting FLEX® equity options, 100 contracts in the case of an opening transaction, or 25 contracts or the remaining size in the case of a closing transaction, whichever is less; or

(iii) respecting FLEX® currency options, 25 contracts, or the remaining size on a closing transaction, whichever is less.

(C) **Responsive** --The minimum value size for a responsive quote, other than an assigned ROT or assigned Specialist, is (includes non-assigned ROTs and a non-assigned Specialist):

(i) respecting FLEX® index options, \$1 million underlying equivalent value respecting index options, or the remaining size on a closing transaction, whichever is less. However, an assigned ROT and assigned Specialist are required to respond with at least \$10 million underlying equivalent value respecting FLEX® market index options, and \$5 million underlying equivalent value respecting FLEX® industry index options, or the size amount requested in the RFQ, whichever is less; [or]

(ii) respecting FLEX® equity options, 25 contracts, or the remaining size on a closing transaction, whichever is less. However, an assigned ROT and assigned Specialist are required to respond with at least 250 contracts, or the size amount requested in the RFQ, whichever is less; or

(iii) respecting FLEX® currency options, 50 contracts, or the remaining size on a closing transaction, whichever is less. However, an assigned ROT and assigned Specialist are required to respond with at least 250 contracts, or the size amount requested in the RFQ, whichever is less.

(D) No Change.

(9) Settlement

(A) respecting FLEX® index options, the settlement value may be specified as the index value reported at the: (i) close (P.M.-settled); (ii) opening (A.M.-settled) of trading on the Exchange, or (iii) as an average over a specified period of time, within parameters established by the Exchange. American style index options exercised prior to the expiration date can only settle based on the closing value on the exercise date. FLEX® index options may be designated for settlement in U.S. dollars, British pounds, Canadian dollars, Japanese yen or Swiss francs; [or]

(B) respecting FLEX® equity options, exercise settlement shall be by physical delivery of the underlying security pursuant to Rule 1044; or

(C) The settlement value for FLEX® options on the Australian dollar, the Euro and the British pound shall be the day's announced Noon Buying Rate, as determined by the Federal Reserve Bank of New York on the expiration date. If the Noon Buying Rate is not announced by 5:00 p.m. (Eastern time ("ET")), the closing settlement value will 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 for FLEX® options on the Canadian dollar, the Swiss franc and the Japanese yen shall be an amount equal to one divided by the day's announced Noon Buying Rate, as determined by the Federal Reserve Bank of New York on the expiration date, rounded to the nearest .0001 (except in the case of the Japanese yen where the amount shall be rounded to the nearest .000001). If the Noon Buying Rate is not announced by 5:00 p.m. (Eastern time ("ET")), the closing settlement value will be based upon the most recently announced Noon Buying Rate, unless the Exchange determines to apply an alternative closing settlement value as a result of extraordinary circumstances. FLEX® currency options will cease trading at 10:15 a.m. eastern time on their designated expiration date.

(10) No Change.

(b) Procedure for Quoting and Trading FLEX® Options. FLEX® options will not be continuously quoted and series are not pre-established. The Exchange's Automated Options Market ("AUTOM") System will not be available for FLEX® options. The variable terms of FLEX® options shall be established through the process described in this Rule. All transactions must be in compliance with Section 11 of the Securities Exchange Act of 1934 and the rules promulgated thereunder, which may include yielding priority to customer orders.

(1) **Requesting Quotations.** The Requesting Member may initiate a Request-for-Quote by first announcing all of the following contract terms to the trading crowd of the non-FLEX® option and then submitting an RFQ ticket to that specialist post: (1) underlying index, [or] security or foreign currency, (2) type, size and crossing intention (3) in the case of FLEX® index options and FLEX® equity options, exercise style, (4) expiration date, (5) exercise price, and, respecting index options, [(6)] the settlement value and [(7)] the currency. Thereafter, on receipt of an RFQ in proper form, the assigned Specialist or Requesting Member shall cause the terms of the RFQ to be disseminated as an administrative text message through the Options Price Reporting Authority ("OPRA").

(2) - (4) No Change.

(5) **Trading.** A trade in FLEX® options cannot be executed until the end of the response time or BBO Improvement Interval. Once the response time or Improvement Interval ends, the Requesting Member is given the first opportunity to trade on the market, by voicing a bid/offer in the trading crowd. The Requesting Member has no obligation to accept any bid or offer for a FLEX® option. If the Requesting Member rejects the BBO or the BBO size exceeds the entire size requested, another member may promptly accept such BBO or the unfilled balance of the BBO.

(A) No Change.

(B) **FLEX® Book** --The Specialist in the listed non-FLEX® equity, [or] index or U.S. dollar-settled foreign currency option, whether or not assigned in FLEX® options, must accept FLEX® orders on the FLEX® book after completion of the RFQ process. Only customer day limit orders may be placed on the FLEX® index, [or FLEX®] equity or U.S. dollar-settled foreign currency option book. Booked orders expire at the end of each trading day. The limit price and size must be written on the RFQ ticket and submitted for dissemination. In order to trade with the book, an executing member must quote the market and announce the trade.

(C) No Change.

(6) - (9) No Change.

(c) No Change.

(d) Position Limits.

(1) - (2) No Change.

(3) Positions in FLEX® currency options will be aggregated with positions in non-FLEX® U.S. dollar-settled foreign currency option contracts as well as physical delivery foreign currency option contracts for purposes of determining compliance with the position limits established by Rule 1001. Like non-FLEX® U.S. dollar-settled foreign currency contracts, (i) one British pound FLEX® option contract shall count as one third of a contract, (ii) one Euro FLEX® option contract shall count as one sixth of a contract, (iii) one Australian dollar FLEX® option contract shall count as one fifth of a contract, (iv) one Canadian dollar FLEX® option contract shall count as one fifth of a contract, (v) one Swiss Franc FLEX® option contract shall count as one sixth of a contract, and (vi) one Japanese yen FLEX® option contract shall count as one sixth of a contract.

(e) Exercise Limits. In determining compliance with Rules 1002 and 1002A, exercise limits for FLEX® options shall be equivalent to position limits established in this Rule. Positions in FLEX® options shall not be taken into account when calculating exercise limits for non-FLEX® options, except as provided in paragraph (d) above. The minimum exercise size shall be the lesser of \$1 million underlying equivalent value for FLEX® index options, and 25 contracts for FLEX® equity and currency options, or the remaining size of the position.

(f) FLEX® equity and currency options shall be subject to the exercise-by-exception procedure of Rule 805 of the Options Clearing Corporation.

F-28 Trading FLEX® Index, [and] Equity and Currency Options

A Requesting Member shall obtain quotes and execute trades in non-listed FLEX® options at the specialist post of the non-FLEX® option on the Exchange, pursuant to Rule 1079. FLEX® options will not be continuously quoted and series are not pre-established. The variable terms of FLEX® options shall be established through the process described in the Rule. All transactions must be in compliance with Section 11 of the Securities and Exchange Act of 1934 and the Rule promulgated thereunder, which may include yielding priority to customer orders.

(1) Requesting Quotations. The Requesting Member may initiate a Request-for-Quote

(RFQ) by first announcing all of the following contract terms to the trading crowd of the non-FLEX® option and then submitting an RFQ ticket to the trading crowd of the non-FLEX® option and then submitting an RFQ ticket to that specialist post:

(1) underlying index, [or] security or foreign currency,

(2) - (7) No Change.

Thereafter, on receipt of an RFQ in proper form, the Requesting Member shall cause the terms of the RFQ to be disseminated as an administrative text message through the Options Price Reporting Authority ("OPRA").

(2) - (4) No Change.

(5) Trading. A trade in FLEX® options cannot be executed until the end of the response time or BBO Improvement Interval. Once the response time or Improvement Interval ends, the Requesting Member is given the first opportunity to trade on the market, by voicing a bid/offer in the trading crowd. The Requesting Member has no obligation to accept any bid or offer for a FLEX® option. If the Requesting Member rejects the BBO or the BBO size exceeds the entire size requested, another member may promptly accept such BBO or the unfilled balance of the BBO.

(A) RFQ Remains Open --Once the BBO is established and no trade has occurred, the RFQ remains open during that trading day, such that a member may re-quote the market with the respect to the open RFQ, as opposed to submitting an additional RFQ. An assigned ROT or assigned Specialist who responded to the open RFQ during the response time or BBO Improvement Interval may immediately join the re-quoted market, thus matching for parity purposes. The Requesting Member is not given the first opportunity to trade on the re-quoted market, nor is the re-quoting member. If a trade occurs, that RFQ is no longer open and a new RFQ is required.

(B) FLEX Book --The Specialist in the listed non-FLEX® equity, [or] index or U.S. dollar-settled foreign currency option, whether or not assigned in FLEX® options, must accept FLEX® orders on the FLEX® book after completion of the RFQ process. Only customer day limit orders may be placed on the FLEX® index, [or FLEX®] equity or U.S. dollar-settled foreign currency option book. Booked orders expire at the end of each trading day. The limit price and size must be written on the RFQ trade ticket and submitted for dissemination. In order to trade with the book, an executing member must quote the market and announce the trade.

(C) Acceptance of a bid/offer creates a binding contract under Exchange rule.

(6) Crossing. Whenever a Requesting Member intends to cross, after the BBO is determined, with or without a BBO Improvement Interval, the Requesting Member, having announced an intention to cross, must bid and offer at or better than the BBO.

(A) No Change.

(B) No Change.

(C) No Change.

For additional provisions governing FLEX® options, see Rule 1079.