OMB APPROVAL
OMB Number: 3235-0045 Estimated average burden hours per response............38

Required fields are shown with yellow backgrounds and asterisks.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No.* SR - 2012 - * 82
Amendment No. (req. for Amendments *)

Proposed Rule Change by NASDAQ OMX PHLX LLC.

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial *	Amendment *	Withdrawal	Section 19(b)(2) *	Section 19(b)(3)(A) *	Section 19(b)(3)(B) *
☑	☐	☐	☑	☐	☐

Rule

Pilot	Extension of Time Period for Commission Action *	Date Expires *	19b-4(f)(1)	19b-4(f)(2)	19b-4(f)(3)	19b-4(f)(4)	19b-4(f)(5)	19b-4(f)(6)
☐	☐		☐	☐	☐	☐	☐	☐

Exhibit 2 Sent As Paper Document ☐

Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the proposed rule change (limit 250 characters, required when Initial is checked *).

A proposal to implement twenty-five new rules in the 1000D Series of rules so that the Exchange may list options on Treasury securities and allow trading thereon.

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name * Jurij Last Name * Trypupenko

Title * Associate General Counsel

E-mail * jurij.trypupenko@nasdaqomx.com

Telephone * (301) 978-8132 Fax (301) 978-8472

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date 06/19/2012

By Edward S. Knight
(Name *)

Executive Vice President and General Counsel
(Title *)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Edward S Knight,

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information (required) Add Remove View	The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.
Exhibit 1 - Notice of Proposed Rule Change (required) Add Remove View	The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)
Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications Add Remove View Exhibit Sent As Paper Document ☐	Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.
Exhibit 3 - Form, Report, or Questionnaire Add Remove View Exhibit Sent As Paper Document ☐	Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.
Exhibit 4 - Marked Copies Add Remove View	The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.
Exhibit 5 - Proposed Rule Text Add Remove View	The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.
Partial Amendment Add Remove View	If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Changes

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] NASDAQ OMX PHLX LLC (“Phlx” or “Exchange”) is filing with the Securities and Exchange Commission (“Commission”) a proposal to implement twenty-five new rules in the 1000D Series of rules so that the Exchange may list options on Treasury securities[3] and allow trading thereon.[4]

A notice of the proposed rule change for publication in the Federal Register is attached hereto as Exhibit 1 and the text of the proposed rule change is attached as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

---

1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 Subsection (a)(1) of proposed Rule 1001D states that the term "Treasury securities" (also known as Treasury debt securities) means 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 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 United States Treasury).

4 Exchange listing and trading rules are organized as noted. Generally, rules applicable to equity and currency options can currently be found at Rule 1000 et seq.; rules applicable to index options can be found at Rule 1000A et seq.; rules applicable to cash index participations can be found at Rule 1000B et seq.; and rules applicable to PHLX Forex Options can be found at Rule 1000C et seq. Rules applicable to Treasury security options are being proposed at Rule 1000D et seq.

2. Procedures of the Self-Regulatory Organization

The Board of Directors of the Exchange ("Board") approved the submission of this proposed rule change on December 19, 2011. No other action by the Exchange is necessary for the filing of the rule change.

Questions and comments on the proposed rule change may be directed to Jurij Trypupenko, Associate General Counsel, NASDAQ OMX, at (301) 978-8132.

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

a. Purpose

The purpose of this filing is to implement Exchange Rules 1000D through 1025D (the "1000D Series"), which would, in conjunction with current applicable Exchange rules and procedures, allow the Exchange to list options on Treasury securities ("Treasury securities options"). The Exchange could then allow trading on Treasury securities options.

Background

Treasury securities are direct debt obligations issued by the U.S. government that are used by the government to raise capital and/or make payments on outstanding debt and by traders and investors, both in the underlying form and as derivatives proposed by this filing, as trading, investing, and hedging vehicles. Since Treasury securities are backed by the full faith and credit of the U.S. government, they are generally considered to have low risk and typically carry lower yields than other debt securities. Marketable Treasury securities are initially sold in a scheduled auction process and thereafter trade in a secondary market that is recognized as among the most liquid and extensively reported in the world.

The Exchange believes the prices of Treasury securities are widely disseminated, active, and visible to traders and investors, In addition, the Exchange intends to make real-time Treasury prices available to member organizations that wish to obtain them directly from the Exchange instead of another service provider; the Exchange would also use these prices in support of its market, regulatory and surveillance operations. Thirty days prior to the start of trading the Exchange would make an announcement, via an Options Trader Alert ("OTA"), to its member organizations regarding the details of the proposed real-time Treasury price offering.[5]

The secondary market for Treasury securities is an over-the counter ("OTC") market in which participants trade with one another on a bilateral basis rather than on an organized exchange (Treasury securities can trade at the New York Stock Exchange, but trading in that market is negligible). Trading activity takes place between primary dealers; non–primary dealers; and customers of these dealers, including financial institutions, nonfinancial institutions, and individuals. There are a variety of databases providing bond information, including information regarding the listing and/or trading location of a bond, such as, for example, Govpx, Standard & Poor's Bond Guide, the Mergent Bond Record, First Data Services' BORAS, Bloomberg, and the Commission's EDGAR internet service.[6] Whereas options on Treasury securities will be cleared by The

---

5 The Exchange believes, however, that irrespective of any real-time Treasury price offering by the Exchange, broker dealers do not, as a rule, offer new options classes for trading unless these brokers have an ability to provide transparent, real-time prices for the underlying in addition to options chains.

6 The prices of Treasury Securities are widely disseminated, active and visible. There is a high level of price transparency for Treasury securities because of extensive price dissemination to the investing public (e.g. commercial and investment banks, insurance companies, pension funds, mutual funds, and retail investors) of price information by information vendors. These information

Options Clearing Corporation ("OCC") as discussed, the underlying securities will be cleared at the National Securities Clearing Corporation ("NSCC") or the Fixed Income Clearing Corporation ("FICC"), as applicable.

This filing would allow the Exchange, as permissible by rule on other options exchanges,[7] to list and trade standardized options[8] on two specific types of marketable

---

vendors include an industry-sponsored corporation, Govpx, that disseminates price and real-time trading volume information for Treasury securities via interdealer broker screens.

Moreover, retail brokers (e.g. Fidelity, TD Ameritrade, E*TRADE, Charles Schwab, Interactive Brokers, and Scottrade) offer market access and the ability to purchase and sell Treasury securities on a real time basis, similarly to equity securities. For example, on May 8, 2012, Fidelity Investments displayed live bid/ask quotes with size offered on its retail brokerage website for the current on-the-run 30-YR Treasury bond (the 3.125% bond due February 15, 2042) and the previous seventeen issued on-the-run 30-YR Treasury bonds starting with the due date of February 15, 2036.

On-the run Treasury bonds are generally the most recently issued U.S. Treasury bonds or notes of a particular maturity. For additional information, see http://www.investopedia.com/terms/o/on-the-runtreasuries.asp#ixzz1uVP4BzfS.

7 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)(SR-Amex-81-1; SR-CBOE-81-27)(order initially approving CBOE and Amex (now NYSE Amex) to list and trade options contracts on securities issued by the U.S. Treasury). The Exchange does not believe that currently these markets list options on debt securities issued by the U.S. Treasury or Government.

8 Standardized options are options contracts trading on a national securities exchange, an automated quotation system of a registered securities association, or a foreign securities exchange that relate to options classes the terms of which are limited to specific expiration dates and exercise prices, or such other securities as the Commission may, by order, designate. 17 CFR 240.9b-1(a)(4). Standardized options are cleared by the OCC, which takes the position of counter-party in such transactions.

Treasury securities issued by the Treasury: notes and bonds.[9] These options overlie individual underlying Treasury securities. Such options having a specifically identified underlying Treasury security will be known as "specific cusip options." Similarly to equity and index options, these would be required to be delivered upon exercise.[10]

The Exchange believes that the ability to trade standardized options overlying Treasury securities as proposed in this filing would serve an important economic function. In particular, such options could be used by a wide range of investors and traders that may be sensitive to, among other things, the potential price risk of alternative underlying securities and interest rate changes. Through the use of various option purchasing, writing (selling), and combination strategies, investors and traders would be able to use options on Treasury securities as short and long-term investment vehicles; as viable alternatives to potentially more risky derivative vehicles; and as a hedge against equity, option, or other security positions or against the risks associated with inverse interest rate movements while retaining the opportunity to profit from favorable movements.

The Exchange contends that trading Treasury securities options on the Exchange, as proposed, offers several distinct benefits.[11] First, options on Treasury securities would

---

9 Subsection (b)(1) of proposed Rule 1026D and subsections (a)(2) and (a)(3) of proposed Rule 1001D, respectively. Other types of marketable securities issued by the Treasury (e.g. Treasury Inflation Protected Securities or TIPS) and non-marketable Treasury securities (e.g. government savings bonds) are not instruments that may underlie options for listing and trading.

10 Subsection (a)(4) of proposed Rule 1001D.

11 The Exchange currently allows the trading of certain options that may reference Treasury Securities. Commentary .09(a)(iv) to Rule 1009 states that securities deemed appropriate for options trading currently include shares or other securities including Fixed Income Index-Linked Securities (“Fixed Income ILS”). Fixed

be traded in a highly regulated and transparent exchange environment. Second, as a result of the standardization of Treasury securities option contracts in conjunction with quoting and market making requirements, such option contracts should develop more liquid and deeper markets. Third, counterparty credit risk would be mitigated because the contracts would be issued and guaranteed by the OCC. And fourth, the quotation and last-sale data provided by the Exchange to the options processor, Options Price Reporting Authority ("OPRA") and its members would lead to more transparent markets. The Exchange believes that expanding the universe of listed products available to market participants interested in Treasury securities options by listing such options on the Exchange could significantly increase competition with other exchanges that have the capability to list and trade derivatives on Treasury securities[12] as well as with the OTC market.[13]

Income ILS are described as securities that provide for the payment at maturity of a cash amount based on the performance or the leveraged (multiple or inverse) performance of one or more notes, bonds, debentures or evidence of indebtedness that include, but are not limited to, U.S. Department of Treasury securities, government-sponsored entity securities, municipal securities, trust preferred securities, supranational debt and debt of a foreign country or a subdivision thereof or a basket or index of any of the foregoing ("Fixed Income Reference Asset").

[12] For example, Chicago Board of Trade ("CBOT") lists futures and options on futures on Treasury securities (and other debt instruments). CBOE lists options on exchange traded funds and other vehicles that are invested in Treasury securities.

[13] Exchange listed options are viewed as a viable, liquid alternative to OTC options. This is, as discussed, because exchange listed options do not possess the negative characteristics often associated with non-exchange listed (OTC) options, such as lack of transparency; counterparty risk; and insufficient regulation, clearing arrangements, collateral requirements, and trade processing. The Exchange/OTC market distinction and the safeguards of central clearing and SRO regulation have become particularly evident and significant in the recent economic downturn.

Exchange Rules Are Applicable

The Exchange establishes the controlling principle that its existing rules and procedures are applicable to options on Treasury securities and the proposed rules would supplement existing Exchange rules. Proposed Rule 1000D states that unless otherwise specified, the rules in the 1000D Series are applicable only to options on Treasury securities. The rule states further that except to the extent that specific rules in the 1000D Series govern, or unless the context otherwise requires, the provisions of the Option Rules applicable to equity options[14] and of the By-Laws[15] and all other Rules and Policies of the Board of Directors[16] (together referred to as "current Exchange rules") are applicable to the trading on the Exchange of options on Treasury securities. The Exchange underscores the general controlling principle that current Exchange rules are applicable by referring to current option rules in certain proposed Treasury securities options rules.[17]

---

[14] Option Rules 1000 et seq.

[15] By-Laws Articles I to VII.

[16] Rules of the Exchange Rule 1 et seq. and Options Floor Procedure Advices.

[17] For example, proposed Rule 1004D refers to current Rules 1001 regarding position limits, 1003 regarding reporting of options positions, and 1004 regarding liquidation of positions. Proposed Rules 1011D and 1012D refer to current Rule 1047 regarding trading rotations, halts and suspensions. Proposed Rule 1014D refers to current Rule 1014 regarding obligations and restrictions applicable to specialists and Registered Options Traders ("ROTs"; specialists and ROTs are defined in Rules 1020 and 1014 (b)(i), respectively), and Rule 1080 regarding electronic trading via Phlx XL and XL II. Proposed Rule 1015D refers to current Rule 1059 regarding accommodation trading. Proposed Rule 1019D refers to current Rule 1014 regarding obligations and restrictions applicable to specialists and ROTs and 1047 regarding trading halts. Proposed Rule 1020D refers to current Rule 1043 regarding exercise assignment notices. Proposed Rule 1022D refers to Rule 721 regarding margin. Proposed Rule 1023D refers to current Rule 1022 regarding identification of accounts and reports of specialists and ROTs.

Treasury securities options will generally trade on the Exchange's electronic options platform, Phlx XL[18] and settle like equity options on the Exchange. As noted, therefore, Exchange rules applicable to equity options trading will be applicable to Treasury securities options unless there is a specific rule in the 1000D Series to the contrary or a proposed rule supplements an existing rule.

Treasury securities options will be physically settled, European-style options that may be exercised only on the day that they expire.[19] Trading in Treasury securities options ordinarily will cease on the business day (usually a Friday) preceding the expiration date. 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.[20] The expiration date will be the Saturday immediately following the third Friday of the expiration month.[21]

Definitions

Definitions applicable to Treasury securities and options on them are found in proposed Rule 1001D. Regarding products underlying options to be traded on the Exchange subsection (a)(1) states that "Treasury securities" represent 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 United States

---

18 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).

19 Proposed Rules 1008D(c) and 1026(D)(e).

20 Proposed Rule 1010D. For trading hours on the Exchange, see Rule 101.

21 Specifications for options on Treasury securities may be found at www.nasdaqtrader.com.

has a direct or indirect interest.[22] Next, the terms “bond” and “note” are defined. Subsection (a)(2) of proposed Rule 1001D states that Treasury notes are interest-bearing debt instruments issued by the U.S. Treasury with a term to maturity of at least two years but no more than ten years at the time of original issuance. Subsection (a)(3) states that Treasury bonds are interest-bearing debt instruments issued by the U.S. Treasury with a term to maturity of more than ten years at the time of original issuance.

The Exchange establishes two exercise price definitions in proposed Rule 1001D: exercise price and aggregate exercise price.[23] The Exchange also establishes the concept of a covered short call and put position in Treasury securities options.[24]

---

22 See supra note 3.

23 Subsections (a)(5) and (a)(6) of Rule 1001D, respectively, state: “Exercise price" in respect of a specific cusip option means the specified price at which the underlying Treasury security may be purchased or sold upon the exercise of the option contract. "Aggregate exercise price" in respect of a specific cusip option means the exercise price of an option contract multiplied by the principal amount of the underlying Treasury security covered by the option.

24 Subsection (a)(7) of rule 1001D states: The term "covered" in respect of a short position in a Treasury security call option contract means that the writer holds in the same account on a principal for principal basis: (1) a long position in underlying Treasury securities that qualify for delivery upon exercise; (2) a long Treasury securities call option position for the same underlying security as the short call position where the expiration date of the long call position is the same as or subsequent to the expiration date of the short call position and the exercise price(s) of the long call position is equal to or less than the exercise price of the short call position; or (3) a custodial or Treasury securities escrow receipt pursuant to Rule 1022D.

The term "covered" in respect of a short position in a Treasury security put option contract means that the writer holds in the same account on a principal for principal basis: (1) a long Treasury security put option position for the same underlying security as the short put position where the expiration date of the long put position is the same as or subsequent to the expiration date of the short put position and the exercise price(s) of the long put position is equal to or greater than the exercise price of the short put position or (2) a Treasury security put guarantee letter pursuant to Rule 1022D.

Designation and Commencement of Trading

Treasury securities options will use a convention for describing (designating) options that is uniquely adapted to the nature of such options. Specifically, proposed Rule 1005D states that Treasury options purchased and sold on the Exchange 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. For example, a specific cusip call option expiring in March and having an exercise price of 96 of the $10,000 principal amount of a 3 3/4% Treasury bond that matures on August 15, 2041, would be designated as a Treasury 3 3/4%—8/15/41 March 96 call.

Regarding specific cusip Treasury security options, subsection (a) to proposed Rule 1009D states that at any time after an auction sale of an underlying Treasury security, if the Exchange decides to initially open options for trading the Exchange shall open a minimum of one expiration month and series for each class of options.[25] These series are opened pursuant to the "opening timeframe" concept established in Rule 1006D, which is discussed below.[26] The Exchange notes that while the "opening timeframe" concept is specific to Treasury securities options, the minimum one expiration month and one series requirement is wholly consistent with a similar requirement for other options traded on the Exchange.[27]

---

25 A single Treasury security option covers $10,000 principal amount of the underlying security. Proposed Rule 1008D.

26 Rule 1012.

27 See Rule 1101A (narrow and broad-based index options).

Additional series may also be opened when the Exchange deems it necessary to maintain an orderly market, to meet customer demand or to reflect substantial changes in the prices of underlying Treasury securities.[28] These series are opened pursuant to the "additional series" concept established in Rule 1006D. The Exchange will give notice that it is opening any such additional options.[29]

Terms and Criteria for Listing and Trading

The Exchange proposes rules setting forth the initial and continued (maintenance) listing standards for Treasury securities options.

Specifically, subsection (a) of proposed Rule 1006D states that 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, aggregate principal amount outstanding, and years to maturity.

Additionally, the following factors must be met:

(1) The original public sale of an underlying Treasury security shall be at least $1 billion principal amount.

(2) The approval of such an underlying Treasury security will ordinarily extend for the current auction of the underlying Treasury security through the end of the final month of such auction ("opening timeframe"), and additional series of options opened thereafter will relate to more recently issued Treasury

---

[28] While the "additional series" concept is specific to Treasury securities options, the proposed series add procedure is otherwise similar to the process for adding other option series on the Exchange. See Rule 1012 in respect of equity and ETF options. As discussed, the exercise price of an option must be reasonably close to 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. Proposed Rule 1008D.

[29] The Exchange generally provides notice via OTA or the Exchange web site.

securities within the opening timeframe ("additional series"). This is done to limit underlying securities for specific cusip options to the most recently issued and actively traded issues.[30]

Proposed Rule 1007D states in subsection (a) that the Board (or a designee of the Board) may determine, for any reason, to withdraw approval of any Treasury securities that were initially approved for options trading pursuant to Rule 1006D as underlying securities.[31] Subsection (b) states that after any announcement by the Exchange of such withdrawal of approval, each member organization shall, if requested by a customer to effect an option transaction in such Treasury securities, inform such customer of the withdrawal of approval prior to affecting any transactions in such securities.

Minimum Price Variation and Bids and Offers

Proposed Rule 1013D discusses minimum increment and the unique meaning of bids and offers for options on Treasury securities. Specifically, subsection (a) provides that Treasury securities options shall have a minimum increment of $.01. Subsection (b) similarly provides that bids and offers for Treasury securities options shall be expressed in $.01 increments. The Exchange believes that the proposed $.01 increments are uniform and particularly appropriate for Treasury securities options to allow traders to

---

30 Provided that, in respect of this second requirement, such approval may be extended in the event of the reopening of the underlying security by the Treasury, or in the event of issues where a reasonably active secondary market exists. Further, even prior to the end of such opening timeframe and additional series, the Board (or a designee of the Board) shall withdraw approval of an underlying Treasury security at any time if it determines on the basis of information made publicly available by the Treasury that the security has a public issuance of less than $750 million, excluding stripped securities. Proposed Rule 1006D(a)(2).

31 As with other options products (e.g. equity options, index options), Treasury security options that are no longer approved but have open interest would remain open for closing transactions only so that the open interest can trade out or expire.

make the most effective use of the product for trading and hedging purposes. The Exchange believe further that the proposed $.01 increments will not cause any capacity problems.

Penny increments have been used very effectively for more than five years on the Exchange as well as on other options markets. First, the Commission has approved the use of penny increments pursuant to the Penny Pilot, pursuant to which some of the highest-volume options trade in penny increments for series of options less than $3.00.[32] Second, the Commission has approved the use of penny increments for certain categories of products on the Exchange such as, for example, foreign currency options (FCOs, also known as World currency Options or WCOs).[33] Third, the Commission has approved the use of penny increments for specific option products on the exchange such as Alpha

32 These include the highest-volume options overlying the PowerShares QQQ Trust (QQQQ)®, the SPDR S&P 500 Exchange Traded Funds (SPY), and the iShares Russell 2000 Index Funds (IWM) which, unlike other Penny Pilot options, trade at penny increments regardless of the price (the Penny Pilot establishes $.05 increments where the price is $3.00 or higher). See Securities Exchange Act Release No. 55153 (January 23, 2007), 72 FR 4553 (January 31, 2007)(SR-Phlx-2006-74)(notice of filing and approval order establishing Penny Pilot); and Rule 1034. All other options exchanges have similar penny pilot programs.

The Exchange notes that the Penny Pilot has structural limitations that make it wholly inappropriate for Treasury securities options. The Penny Pilot is, for example: a) available only for a limited number of equity, index, and ETF options, and all of the available slots are already used; b) designed to be used by other exchanges that have similar pilots to multiply list and trade options, but as noted all other penny pilot markets do not have rules that would allow them to list Treasury securities options; and c) is severely limited in terms of price below $3.00.

33 See Securities Exchange Act Release No. 60169 (June 24, 2009), 74 FR 31782 (July 2, 2009)(SR-Phlx-2009-40)(order approving listing and trading of FCOs or WCOs at penny increments); and Rule 1034.

Index Options.[34] Fourth, the Commission has approved penny increments for various option products traded on other exchanges.[35] As such, the Exchange believes that penny increments are proper for Treasury securities options and represents that it has the necessary system capacity to support any additional Treasury securities option series that are listed pursuant to this proposal.

It is clear that inadequately narrow Treasury securities option intervals negatively impact trading and hedging opportunities.

As an example, if the increments were set at another interval level such as $0.50 instead of the proposed $0.01, and an investor wanted to spend no more than $375 to buy a down-side hedge with a put option on a Treasury bond currently trading 102.00, the investor would have the following strikes available from which to chose: an at-the-money ("ATM") 102 put and an out-of-the-money ("OTM") 101 put. If the bid/ask quote for the ATM 102 put was $350/$400, then the investor may elect not to pay $400 and may

---

34 See Securities Exchange Act Release No. 63860 (February 7, 2011), 76 FR 7888 (February 11, 2011)(SR-Phlx-2010-176)(order approving listing and trading Alpha Index Options); and Rule 1034.

35 See Exchange Act Release Nos. 64991 (July 29, 2011), 76 FR 47280 (August 4, 2011)(SR-CBOE-2011-039)(order approving listing and trading single stock dividend options in penny increments); 63352 (November 19, 2010), 75 FR 73155 (November 29, 2011)(SR-CBOE-2011-046)(order approving amendments regarding credit default options, including penny increments); 31169 (May 22, 2008), 73 FR 31169 (May 30, 2008)(SR-CBOE-2006-105)(order approving listing and trading binary options on broad-based securities in penny increments); and 58486 (September 8, 2008), 73 FR 53298 (September 15, 2008)(SR-ISE-2008-36)(notice and filing and immediate effectiveness proposing to permit ISE members to enter non-displayed electronic orders and quotes in penny increments, citing to SR-CBOE-2007-39 and SRNASDAQ-2007-004 and SR-NASDAQ-2007-080). See also NYSE Arca Equities Rule 7.6, Commentary .03, which indicates that the minimum price variation for quoting and entry of orders in equity securities traded on Arca is $.01, with the exception of securities that are priced less than $1.00 for which the MPV for order entry is $0.0001.

subsequently choose the lower OTM 101 put. Even if the resulting 101 put had a bid/ask of $200/$250, thereby allowing the investor to make a purchase for less than $375, the investor would have a different risk/reward scenario because the lower put would not represent an ATM hedge. Accordingly, the investor would have to carry the Treasury bond position with risk of market movement down to the 101 strike before the put becomes an ATM put. If, on the other hand, the proposed $0.01 intervals were effective, and the same investor had a choice of the same strikes from which to choose (an ATM 102 put and an OTM 101 put), at $0.01 intervals the premium cost for a hedge using the ATM 102 put may be about $359 to $360. This would garner the investor as much as a $40 or 10% savings in the cost to put on the desired hedge. The proposed interval range would clearly be very advantageous to investors; and would be costly if not available.

And as yet another example, if an investor were interested in purchasing a complex option spread, narrow option intervals would offer additional cost savings and choice. Using the noted 102 and 101 put example, an investor may choose to purchase (go long) a put spread as a hedge; this would be a complex order where the investor would buy the higher strike and simultaneously sell the lower strike for a debit. If the strike price increments were set at $0.50 and an investor wanted to spend no more than $150 to buy a down-side hedge via a long put spread, and the bid/ask of the 102 put was $350/$400 and the 101 put was $200/$250, the premium cost to the investor would be $200 (simultaneous purchase of the 102 put for $400 and sale of the 101 put for $200). However, if the proposed $0.01 intervals were effective, and an investor wanted to spend no more than $150 to buy a down-side hedge via a long put spread, and the bid/ask of the 102 put was $359/$360 and of the 101 put was $220/$221, the premium cost would be

$140 (simultaneous purchase of the 102 put for $360 and sale of the 101 put for $220). This would garner the investor as much as a $60 or 30% savings in the cost to put on the desired hedge. The proposed interval range would clearly be very advantageous to investors; and would be costly if not available.[36]

Proposed Rule 1014D sets forth that current Rule 1014 is applicable to Treasury securities options. Rule 1014 sets for obligations and restrictions applicable to specialists and ROTs and discusses, among other things, market making obligations, quoting obligations and parameters, and priority. Proposed Rule 1014D also sets forth that Rule 1080 is applicable to Treasury securities options. Rule 1080 discusses the operation of Phlx XL and XL II, which are the Exchange's electronic platform in respect of orders, execution and trades. The Exchange specifically notes Rules 1014 and 1080 in proposed Rule 1014D because of the applicability to Treasury securities options trading of fundament trading-related matters in Rules 1014 and 1080 such as, for example, market making and quoting obligations, priority, and electronic trading.

The Exchange likewise proposes Rule 1019D regarding maximum bids and offers that may be maintained by specialists and ROTs in options on Treasury securities. This rule states that without limiting the general obligation to deal for his account as stated in Rule 1014,[37] a specialist or ROT holding an appointment in Treasury securities options is

---

36 The Exchange notes that in that Treasury security option positions could be quite large because the underlying instruments would be in $10,000 denominations, the percentage savings discussed in the examples could be very significant.

37 Rule 1014 is, similarly to the relationship between current and proposed rules in the filing, supplemented by proposed Rule 1019D. While bid/ask (offer) differentials are set forth for other (non-Treasury securities) options in Rule 1014, specific bid/ask (offer) differentials are set forth for Treasury securities options in proposed Rule 1014D. This is in line with the principle that while current options trading rules (e.g. 1014 and 1080) are applicable to Treasury securities options,

expected, in the course of maintaining a fair and orderly market, to bid and/or offer so as to create differences of:

(1) no more than $0.25 between the bid and offer for each option contract for which the bid is less than $1;

(2) no more than $0.50 where the bid is $1 or more but less than $5;

(3) no more than $0.80 where the bid is $5 or more but less than $10 ; and

(4) no more than $1 where the bid is $10 or more.[38]

Subsection (b) of Rule 1019D states that for all longer term series the maximum bid/ask differentials are double those listed in subsection (a). This subsection states further that the differentials apply only to the two nearest term series of each class of Treasury security options. The Exchange notes that the proposed increments and maximum bid/ask variations are designed to allow the Exchange flexibility to list options with strike increments at appropriate levels, while diminishing any potential adverse effect on the Exchange's quote capacity thresholds. The Exchange believes that the operational capacity used to accommodate the trading of Treasury securities options on the Exchange will have a negligible effect on the total capacity used by the Exchange to trade its products on a daily basis.

<u>Expiration and Exercise</u>

Proposed Rule 1008D discusses expiration and exercise price in respect of Treasury securities options. Subsection (a) states that a single Treasury security option

---

certain rules specifically tailored to Treasury securities options trading are promulgated in this proposal.

38 This is similar to the structure for maximum bids and offers for equity, index, and FCO (WCO) options on the Exchange. See Rule 1014(c).

covers $10,000 principal amount of the underlying security. The expiration month and exercise price of Treasury security options of each series shall be determined by the Exchange at the time each series of options is first opened for trading.[39]

Subsection (b) provides that Treasury security options opened for trading on the Exchange will expire on a monthly basis, none further out than the opening timeframe and additional series as defined in Rule 1006D.[40] Subsection (c) provides that Treasury security options may be exercised only on the day that they expire. The subsection provides further that the exercise price of each series of Treasury security options shall be fixed at a price denominated in $0.50. In the case of a specific cusip Treasury security option, 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.[41] The proposed rule also states that the exercise price of additional series will ordinarily be fixed at a multiple of $0.50.[42]

---

[39] When opening a Treasury security option for trading, the Exchange will open at least one series and one month. Subsection (a) to proposed Rule 1009D.

[40] But cf. CBOE Rule 21.8(b), which allows the CBOE board (or a designee of the board) to provide alternate expiration cycles after notifying traders of Treasury security options.

[41] The Exchange believes that in light of the potential volatility in bond prices, the proposed 20% exercise price band around the underlying is quite reasonable. See, e.g., Commentary .06 to Rule 1012 establishing a 20% volatility band (20% above and 20% below) for currency options (FCOs or WCOs).

[42] The Exchange notes that relatively small portions of a dollar, such as for example a quarter or less, may have a significant effect on exercise prices of positions held by traders and public customers because of the large size of the underlying Treasury securities options. The Exchange notes further that futures on similar Government securities, with which the proposed Treasury securities options would compete, enjoy intervals that are as small as one sixty-fourth of a point (dollar).

Proposed Rule 1020D discusses exercise assignment notices in the case of Treasury securities options. Subsection (a) states that the method of allocation of exercise notices established pursuant to Rule 1043 may provide that an exercise notice of block size[43] shall be allocated to a customer or customers having an open short position of block size; and that an exercise notice of less than block size shall not be allocated, to the extent feasible, to a customer having a short position of block size. In the case of call option contracts, subsection (b) states that a member organization shall allocate an exercise notice to a customer who has made a specific deposit of the underlying security if it is directed to do so by the OCC.

Settlement and Delivery / Payment

Options on Treasury securities will be physically settled and, being European style options, may be exercised only on the expiration date. The settlement process for Treasury securities options will be the same as the settlement process for equity options under current Exchange rules (e.g. Rule 1044).

Subsection (a) to proposed Rule 1021D states, in respect of delivery and payment of options on Treasury securities, that payment of the aggregate exercise price in the case of specific cusip options must be accompanied by payment of accrued interest on the underlying Treasury security. The interest will be from (but not including) the last

---

To minimize the proliferation of strikes, however, the Exchange is proposing somewhat larger $0.50 intervals for Treasury securities option exercise strike prices.

43 For the purposes of this Rule, an exercise notice or a short position in a series of options where the total principal amount is $1 million or more and where the underlying security is a Treasury security shall be deemed to be of "block size." Subsection (c) of Rule 1020D.

interest payment date to (and including) the exercise settlement date as specified in the rules of the OCC.

Position Limits

In determining position limit compliance, proposed Rule 1002D establishes initial and maintenance position limits unique to options on Treasury securities.

Regarding initial position limits, subsection (a) of proposed Rule 1002D provides that the options shall be subject to a contract limitation (whether long or short) of the put type and the call type on the same side of the market covering a value no greater than 7.5% of the value of the initial or reopened public issuance, rounded to the next lower $100 million interval. For purposes of this position limit, there will be a combining of long positions in put options with short positions in call options, and short positions in put options with long positions in call options; or such other lower amount of options as fixed from time to time by the Exchange as the position limit for one or more classes or series of options. Subsection (a)(1) provides that in no event shall the position limit exceed a position on either side of the market covering a value in excess of $750,000,000 of the underlying securities. Subsection (a)(2) requires that the Exchange provide reasonable notice of each new position limit fixed by the Exchange, by notifying members thereof via OTA.

To calculate the proposed $750,000,000 position limit proposed in Rule 1002D, the Exchange is using Position Accountability Levels ("Accountability Levels" or "limits") for Treasury futures and options on such futures on CBOT as the starting basis. Unlike the current situation on options markets, where there is no active trading of Treasury derivatives, CBOT has the most active markets in the U.S. for trading listed futures on Treasuries and options on such futures. The current CBOT Accountability levels, which effectively serve as position limits on CBOT Treasury derivatives,[44] are the equivalent of dollar position limits with a notional value of $2,500,000,000 for options on futures and $1,000,000,000 for futures on Treasury bonds traded on CBOT; and $2,000,000,000 for options on futures and $750,000,000 for futures on Treasury notes traded on CBOT.[45] The Exchange is using these notional position limit values as a starting point to which it applies a conservative methodology to arrive at a proposed $750,000,000 proposed position limit in Rule 1002D for options on Treasury securities traded on the Exchange. First, the Exchange is using the CBOT futures Accountability limit for Treasury bonds (notional value of $1,000,000,000) to establish the proposed position limit for options on Treasury securities. This is because CBOT futures on Treasuries, rather than CBOT options on such futures, are arguably more similar to Exchange options on Treasury securities.[46] Second, the Exchange is then applying a 25% haircut to the $1,000,000,000 notional value for CBOT Treasury futures. This is because Exchange options on Treasury securities would settle into a single cusip Treasury security while CBOT Treasury futures and options settle into the cheapest to deliver Treasury security. And third, when compared to CBOT Treasury options on notes the

---

44 See http://www.cmegroup.com/rulebook/files/CBOTChapter5_InterpretationClean.pdf.

45 The dollar equivalent position limit value for options on Treasury bonds traded on CBOT, as an example, is calculated as follows: 25,000 share CBOT Accountability Level x CBOT Treasury option face value of $100,000 x Phlx option on Treasury security face value of $10,000 = $2,500,000,000.

46 CBOE Treasury futures will, like Exchange options on Treasury securities, settle into the underlying Treasury notes or bonds; CBOT options on Treasury futures, on the other hand, will settle into the underlying derivative instruments (futures).

proposed $750,000,000 position limit for Exchange options on Treasury securities is more that 60% lower that the position limit for CBOT Treasury options on futures (notional value of $2,000,000,000).[47]

The Exchange believes that its very conservative proposed nominal dollar position limit, in conjunction with the proposed equally conservative 7.5% of the value of the initial or reopened public issuance,[48] will minimize (negate) potential manipulation and fraudulent activity in Treasury options.[49]

Regarding maintenance of position limits for Treasury securities options, subsection (b) of proposed Rule 1002D provides that in the event that any of the underlying Treasury securities are reported as "separate trading of registered interest and

---

47 The proposed $750,000,000 position limit for Exchange options on Treasury securities approximates the notional position limit for CBOT Treasury futures on notes.

48 Upon examining U.S. Treasury record setting auction data at http://www.treasurydirect.gov/instit/annceresult/auctdata/auctdata_statdata.htm, which has "Highest Offering Size" for Treasury bonds and notes, the Exchange believes that the proposed 7.5% limit is quite conservative. For example, if the 7.5% maximum were applied to the "Highest Offering Size" for the 30 Year Treasury Bonds, which was $16,000,000,000 on November 12, 2009 (and was $44,000,000,000 for 2-year Treasury notes), the maximum value would be $1,200,000,000. By establishing the proposed, substantially lower position limit of 7.5% and $750,000,000, the Exchange has put into place a mechanism that guards against achieving higher automatic positions limits in all Treasury bonds and notes, including the higher offering size 2-year Treasury notes.

49 The Exchange also notes that its proposed position limits are significantly smaller that the position limits that were approved by the Commission decades ago for trading Treasury options on CBOE. See CBOE Rule 21.3(a), which states, in relevant part that: …Options on a Treasury security shall be subject to a contract limitation (whether long or short) of the put type and the call type on the same side of the market covering a value no greater than 10% of the value of the initial or reopened public issuance, rounded to the next lower $100 million interval…In no event shall the position limit exceed a position on either side of the market covering a value in excess of $1,200,000,000 of the underlying securities.

principal of securities" ("strips") in the Monthly Statement of the Public Debt of the United States Government, or such other report or compilation as may be selected from time to time by the Exchange, such stripping shall be taken into account in determining whether the position limit as initially established under paragraph (a) ("the established position limit") can be maintained (the remaining non-stripped underlying securities are hereinafter referred to as "the non-stripped securities").

Subsection (b)(1) states that the established position limit may remain so long as the position limit covers a principal amount of underlying securities not in excess of 7.5% of the non-stripped securities. However, in the event that the established position limit covers a principal amount of securities in excess of 7.5% of the non-stripped securities, the Exchange shall reestablish the position limit to cover a principal amount of underlying securities not in excess of 7.5% of the non-stripped securities.[50] Subsection (2) provides that except as otherwise exempted under Exchange rules, persons whose positions exceed revised position limits may only engage in liquidating transactions until their positions are lower than the revised position limits.

By virtue of proposed Rule 1003D, exercise limits for options on Treasury securities are equivalent to position limits on these instruments. This is similar to the relationship of position and exercise limits for equity and other options pursuant to current Exchange rules.[51]

---

[50] Such revisions will become effective the Monday following the provision of notice thereof via OTA.

[51] See Rules 1001 and 1002 (equity, ETF, currency options) and Rules 1001A and 1002A (index options).

Moreover, proposed Rule 1004D states that for purposes of Rules 1003 and 1004,[52] references to Rule 1001 in connection with position limits shall be deemed, in the case of Treasury securities options, to be to Rule 1002D. The proposed rule states further that the reference in Rule 1003(a) to reports required of positions of 200 or more options shall, in the case of Treasury securities options, be revised to positions of options covering $2 million or more principal amount of underlying Treasury securities, for example, the 3.125% bonds due in the year 2042.

Margin

The current procedure for establishing margin on the Exchange is in Rule 721. The rule states that member organizations must elect whether they will follow CBOE or New York Stock Exchange ("NYSE") equity option margin rules, notify the Exchange of the election, and comply with the applicable rules.[53] The Exchange proposes to amend Rule 721(b) to state that upon the filing of such election, a member organization engaged in trading Treasury securities options on the Exchange shall, in respect of such trading, comply with the CBOE or NYSE equity option margin rules, as applicable. For clarification purposes, the Exchange specifically states in Rule 721 that CBOE or NYSE Treasury options margin rules are not to be used by member organizations that trade Treasury security options.

---

52 Rule 1003 deals with reporting of options positions and Rule 1004 deals with liquidation of options positions.

53 See Rule 721(b). Moreover, the rules states that the election shall be promptly made in writing by a notice filed with the Exchange; and that each member organization shall be bound to comply with the margin rules of CBOE or NYSE, as applicable, as though said rules were part of the Exchange's Margin Rules.

Proposed Rule 1022D states that Exchange member organizations shall comply with the initial and maintenance margin requirements as set forth in Rule 721. Thus, by operation of proposed Rule 1022D, member organizations involved in trading Treasury security options will be bound by the same CBOE or NYSE equity options margin rules that the member organizations choose for other margin purposes. The Exchange believes that this proposed margin procedure is appropriate for Treasury securities options. First, it ensures consistency in that member organizations must consistently follow the margin rules of either CBOE or NYSE according to their written margin rules election per Rule 721. Second, it is operationally and systemically efficient in that member organizations can immediately apply the margin procedures that they use for equity margin to the proposed new Treasury securities options, and the Exchange can use established margin surveillance processes, thereby reducing the potential for error from all perspectives. And third, the current equity margin rules of CBOE are, without a doubt, more up to date and usable in today's fast-paced hybrid and electronic trading environment than the decades-old CBOE Treasury option margin rules.[54]

Doing Business with the Public

Proposed rule 1025D sets up guidelines dealing with customer account approval and supervisory qualification. Subsection (a) states that approval of the accounts of customers shall be conducted in accordance with Rule 747[55] and, in the case of

---

[54] As an example, CBOE margin rules applicable to equity options have transaction/position specific procedures in CBOE Rule 12.3 as well as modern portfolio margin procedures in CBOE 12.4. Moreover, the Exchange notes that like CBOE, the OCC has portfolio margin procedures and extensive margin rules germane to clearing Treasury security options.

[55] Rule 747, which is applicable to all Exchange member organizations, among other things indicates that prior to making any brokerage transaction for the

institutional options customers (i.e., customers that are not natural persons), a member organization shall seek to obtain the following information:

(1) evidence of authority for the institution to engage in Treasury securities options transactions (corporate resolutions, trust documents, etc.);

(2) written designation of individuals within the institution authorized to act for it in connection with Treasury securities options transactions; and

(3) basic financial information concerning the institution.

Subsection (b) states that as a general matter, supervisory qualifications of a Registered Options Principal may be demonstrated only by successful completion of an examination prescribed by the Exchange (e.g. Series 4) for the purpose of demonstrating an adequate knowledge of Treasury securities options and the underlying Treasury securities.[56] Subsection (c) states that the conduct of Treasury securities option business at a branch office of a member organization may be supervised by any Registered Options Principal of the member organization. Subsection (d) states that any sales personnel of a member organization who solicit or accept customer orders with regard to options on Treasury securities shall be deemed qualified with regard to such options after such personnel successfully completed an examination prescribed by the Exchange for the purpose of demonstrating adequate knowledge of options and the underlying Treasury securities.

---

account of a customer, the opening of a customer account must have been properly approved.

56 In exceptional circumstances and where good cause is shown, however, the Exchange may, upon written request by a member organization, accept as a demonstration of equivalent knowledge other evidence of a Registered Options Principal's supervisory qualifications.

Other Trading-Related Rules

The Exchange proposes additional trading-related rules for Treasury securities options that are similar to certain rules that are applicable to equity and other options. Proposed Rule 1018D states that a limit order book will be available for Treasury securities options. Proposed Rule 1015D states that accommodation trading under the applicable terms and conditions of Rule 1059 will be available in each series of Treasury securities option contracts open for trading on the Exchange. However, bids or offers for opening transactions at a price of $1 per option contract may be executed only with closing transactions that cannot at that time in open outcry be executed with another closing transaction. Proposed Rule 1016D states that all members, member firms, and clearing members shall resolve unmatched trades in Treasury security options from the previous day's trading no later than 9:00 a.m. (Eastern Time) of the following business day. And proposed Rule 1024D permits members to establish and maintain communication links with other members for the purpose of obtaining timely information on price movements in Treasury securities on which options are dealt in on the Exchange.

Proposed Rule 1023D sets forth procedures regarding furnishing of books, records, and other information to the Exchange. Subsection (a) provides that no specialists or ROTs in Treasury securities options shall fail to make available to the Exchange books, records or other information[57] as may be called for under the rules or as may be requested in the course of any investigation, any inspection or other official inquiry by the Exchange. In addition, the provisions governing identification of accounts

[57] More specifically, such books, records, or information as maintained by or in the possession of such member or any corporate affiliate of such member pertaining to transactions by such member or any such affiliate for its own account in Treasury securities, Treasury securities futures or in Treasury securities options.

and reports of orders shall, in the case of specialist or ROTs in Treasury securities options, apply to (i) accounts for Treasury securities deliverable under the terms of the option contracts involved, Treasury securities futures, options on Treasury securities futures and Treasury securities options trading; and (ii) orders entered by the specialist or ROT for the purchase or sale of Treasury securities deliverable under the terms of the options contracts involved, Treasury securities futures, options on Treasury securities futures, options on Treasury securities and opening and closing positions therein. Also, subsection (b) states that any corporate affiliate of a specialist or ROT in Treasury securities options shall maintain and preserve such books, records or other information as may be necessary to comply with this rule.

Proposed Rule 1011D states that Rules 1047 and 1092 are applicable to Treasury securities options. Rule 1047 governs trading halts, rotations and suspensions, and Rule 1092 governs obvious errors and catastrophic errors for equity (and other) options traded on the Exchange. Proposed Rule 1012D(a) states that in addition to the factors set forth in Rule 1047, a factor that may be considered by Options Exchange Officials in connection with the institution of trading halts is that current quotations for the underlying Treasury securities are unavailable or have become unreliable; or that there is a need to prevent an unfair and disorderly market.[58]

Proposed Rule 1012D(b) states that Rule 1092 error procedures shall be applicable to Treasury securities options. The Exchange proposes to amend Rule 1092(a) to state, for purposes of conformity, that Treasury security options will have the same obvious

---

[58] For example, where the underlying Treasuries are still trading, there may be a severe anomaly in the Treasury options market caused by, for example, by an extreme price move in the equities market which triggers a circuit breakers and halts equity and other trading for a period of time.

error thresholds as equity and index options.[59] The Exchange believes that the proposed obvious error threshold, being similar to equity and index options thresholds, will promote consistency and predictability for traders; and that the thresholds are proper in light of the expected trading Treasury options trading ranges.[60] The Exchange also proposes to amend Rule 1092(c)(iv)(D) to state that, similarly to equity options, treasury security option trades on the Exchange will be nullified when the trade occurred during a trading halt of the underlying Treasury security instituted by the United States Government. Unlike other exchange-traded options products that have a primary market for the underlying security (for example, equity options and index options), there is no similar primary market for underlying Treasury securities that are traded over the

---

59 The proposed new language in Rule 1092(a) will add, regarding Treasury securities options, that for purposes of the rule an Obvious Error will be deemed to have occurred when the execution price of a transaction is higher or lower than the Theoretical Price for a series by an amount equal to at least the amount shown below:

For Treasury securities options

Theoretical price	Minimum amount
Below $2	$.25
$2 to $5	$.40
Above $5 to $10	$.50
Above $10 to $20	$.80
Above $20	$1.00

60 Moreover, the Exchange notes that as with any new product, the Exchange will adjust the Treasury options obvious error rule based on experiential need.

counter. As such, a Treasury security options trading halt would be based on a trading halt of the underlying Treasury security instituted by the United States Government.[61]

Surveillance

The Exchange will implement surveillance systems that are being used for equity, ETF, currency, and index options to monitor trading in Treasury securities options. This will include, but not be limited to, monitoring for insider trading, manipulation, front-running, and capping and pegging. The Exchange will also monitor public media for rating downgrades and other relevant actions to ensure that the Exchange's maintenance standards are fulfilled, and will monitor for any material actions that may influence the pricing of Treasury securities and options thereon.

b. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act[62] in general, and furthers the objectives of Section 6(b)(5) of the Act[63] 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 implementing new rules allowing the Exchange to list options on Treasury debt securities and allow trading thereon.

The Exchange believes that the proposed rules for listing and trading Treasury securities options, including options on Treasury notes and bonds, are reasonable and

---

61 As discussed, a Treasury securities option trading halt may also be instituted to prevent an unfair and disorderly market.

62 15 U.S.C. 78f(b).

63 15 U.S.C. 78f(b)(5).

consistent with the Act. The Exchange believes that its proposal would enhance competition and provide access to an additional trading and investing vehicle so that traders and large, institutional, retail, and public investors could more effectively and closely tailor their investing and hedging decisions.

The Exchange has proposed rules that are specifically tailored for trading Treasury security options. Pursuant to these proposed rules, the underlying Treasury securities may be approved as appropriate for listing options subject to requirements as to size of original issuance, aggregate principal amount outstanding, years to maturity or other characteristics as the Exchange may deem necessary or appropriate in the interest of maintaining a fair and orderly market or for the protection of investors. The proposed position limits, exercise limits, margin rules, and other rules, in conjunction with the current Exchange rules, are particularly tailored for Treasury securities options, reasonable, and consistent with the Act. In particular, the proposed position and exercise limits reasonably balance the promotion of a free and open market for these securities with minimization of incentives for market manipulation and insider trading; and the proposed margin rules are reasonably designed to deter a member or its customer from assuming an imprudent position in Treasury securities options.

For these and previously-noted reasons, the Exchange believes that the proposal to allow the Exchange to list and permit trading of Treasury securities options would enhance competition and provide access to valuable additional trading and investing vehicles. These would allow traders and investors - including large and institutional investors and retail and public investors - to more effectively tailor their investing and hedging decisions in the current challenging economic climate.

4. Self-Regulatory Organization's Statement on Burden on Competition

Phlx 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. To the contrary, the Exchange believes that its proposal is pro-competitive. The proposal will allow a new and innovative options product to be listed and traded on the Exchange. This will give market participants the ability to significantly expand their trading and hedging capabilities.

5. 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.

6. Extension of Time Period for Commission Action

The Exchange does not consent to an extension of the time period for Commission action.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

The rules proposed by the Exchange in its 1000D Series are analogous to CBOE Rules 21.1 – 21.31.[64]

---

[64] See Securities Exchange Act Release No. 18371 (December 23, 1981), 46 FR 63423 (December 31, 1981)(SR-AMEX-81-1; SR-CBOE-81-27)(order initially approving CBOE and Amex (now NYSE Amex) to list and trade options contracts on securities issued by the U.S. Treasury).

9. Exhibits

1. Notice of proposed rule for publication in the Federal Register.

5. Proposed Rule Text.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. ; File No. SR-Phlx-2012-82)

June __, 2012

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Notice of Filing of Proposed Rule Change Regarding Treasury Securities Options

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1], and Rule 19b-4[2] thereunder, notice is hereby given that on June 19, 2012, NASDAQ OMX PHLX LLC ("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 is filing with the Securities and Exchange Commission (“Commission”) a proposal to implement twenty-five new rules in the 1000D Series of rules so that the Exchange may list options on Treasury securities[3] and allow trading thereon.[4]

---

1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 Subsection (a)(1) of proposed Rule 1001D states that the term "Treasury securities" (also known as Treasury debt securities) means 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 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

The text of the proposed rule change is available on the Exchange's Website at http://www.nasdaqtrader.com/micro.aspx?id=PHLXRulefilings, at the principal office of the Exchange, and at the Commission's Public Reference Room.

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 this filing is to implement Exchange Rules 1000D through 1025D (the "1000D Series"), which would, in conjunction with current applicable Exchange rules and procedures, allow the Exchange to list options on Treasury securities ("Treasury securities options"). The Exchange could then allow trading on Treasury securities options.

---

department or agency involved (e.g. a "Treasury security" is a debt instrument that is issued by the United States Treasury).

[4] Exchange listing and trading rules are organized as noted. Generally, rules applicable to equity and currency options can currently be found at Rule 1000 et seq.; rules applicable to index options can be found at Rule 1000A et seq.; rules applicable to cash index participations can be found at Rule 1000B et seq.; and rules applicable to PHLX Forex Options can be found at Rule 1000C et seq. Rules applicable to Treasury security options are being proposed at Rule 1000D et seq.

<u>Background</u>

Treasury securities are direct debt obligations issued by the U.S. government that are used by the government to raise capital and/or make payments on outstanding debt and by traders and investors, both in the underlying form and as derivatives proposed by this filing, as trading, investing, and hedging vehicles. Since Treasury securities are backed by the full faith and credit of the U.S. government, they are generally considered to have low risk and typically carry lower yields than other debt securities. Marketable Treasury securities are initially sold in a scheduled auction process and thereafter trade in a secondary market that is recognized as among the most liquid and extensively reported in the world.

The Exchange believes the prices of Treasury securities are widely disseminated, active, and visible to traders and investors, In addition, the Exchange intends to make real-time Treasury prices available to member organizations that wish to obtain them directly from the Exchange instead of another service provider; the Exchange would also use these prices in support of its market, regulatory and surveillance operations. Thirty days prior to the start of trading the Exchange would make an announcement, via an Options Trader Alert ("OTA"), to its member organizations regarding the details of the proposed real-time Treasury price offering.[5]

The secondary market for Treasury securities is an over-the counter ("OTC") market in which participants trade with one another on a bilateral basis rather than on an organized exchange (Treasury securities can trade at the New York Stock Exchange, but

---

5 The Exchange believes, however, that irrespective of any real-time Treasury price offering by the Exchange, broker dealers do not, as a rule, offer new options classes for trading unless these brokers have an ability to provide transparent, real-time prices for the underlying in addition to options chains.

trading in that market is negligible). Trading activity takes place between primary dealers; non–primary dealers; and customers of these dealers, including financial institutions, nonfinancial institutions, and individuals. There are a variety of databases providing bond information, including information regarding the listing and/or trading location of a bond, such as, for example, Govpx, Standard & Poor's Bond Guide, the Mergent Bond Record, First Data Services' BORAS, Bloomberg, and the Commission's EDGAR internet service.[6] Whereas options on Treasury securities will be cleared by The Options Clearing Corporation ("OCC") as discussed, the underlying securities will be cleared at the National Securities Clearing Corporation ("NSCC") or the Fixed Income Clearing Corporation ("FICC"), as applicable.

---

6 The prices of Treasury Securities are widely disseminated, active and visible. There is a high level of price transparency for Treasury securities because of extensive price dissemination to the investing public (e.g. commercial and investment banks, insurance companies, pension funds, mutual funds, and retail investors) of price information by information vendors. These information vendors include an industry-sponsored corporation, Govpx, that disseminates price and real-time trading volume information for Treasury securities via interdealer broker screens.

Moreover, retail brokers (e.g. Fidelity, TD Ameritrade, E*TRADE, Charles Schwab, Interactive Brokers, and Scottrade) offer market access and the ability to purchase and sell Treasury securities on a real time basis, similarly to equity securities. For example, on May 8, 2012, Fidelity Investments displayed live bid/ask quotes with size offered on its retail brokerage website for the current on-the-run 30-YR Treasury bond (the 3.125% bond due February 15, 2042) and the previous seventeen issued on-the-run 30-YR Treasury bonds starting with the due date of February 15, 2036.

On-the run Treasury bonds are generally the most recently issued U.S. Treasury bonds or notes of a particular maturity. For additional information, see http://www.investopedia.com/terms/o/on-the-runtreasuries.asp#ixzz1uVP4BzfS.

This filing would allow the Exchange, as permissible by rule on other options exchanges,[7] to list and trade standardized options[8] on two specific types of marketable Treasury securities issued by the Treasury: notes and bonds.[9] These options overlie individual underlying Treasury securities. Such options having a specifically identified underlying Treasury security will be known as "specific cusip options." Similarly to equity and index options, these would be required to be delivered upon exercise.[10]

The Exchange believes that the ability to trade standardized options overlying Treasury securities as proposed in this filing would serve an important economic function. In particular, such options could be used by a wide range of investors and traders that may be sensitive to, among other things, the potential price risk of alternative underlying securities and interest rate changes. Through the use of various option

---

7 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)(SR-Amex-81-1; SR-CBOE-81-27)(order initially approving CBOE and Amex (now NYSE Amex) to list and trade options contracts on securities issued by the U.S. Treasury). The Exchange does not believe that currently these markets list options on debt securities issued by the U.S. Treasury or Government.

8 Standardized options are options contracts trading on a national securities exchange, an automated quotation system of a registered securities association, or a foreign securities exchange that relate to options classes the terms of which are limited to specific expiration dates and exercise prices, or such other securities as the Commission may, by order, designate. 17 CFR 240.9b-1(a)(4). Standardized options are cleared by the OCC, which takes the position of counter-party in such transactions.

9 Subsection (b)(1) of proposed Rule 1026D and subsections (a)(2) and (a)(3) of proposed Rule 1001D, respectively. Other types of marketable securities issued by the Treasury (e.g. Treasury Inflation Protected Securities or TIPS) and non-marketable Treasury securities (e.g. government savings bonds) are not instruments that may underlie options for listing and trading.

10 Subsection (a)(4) of proposed Rule 1001D.

purchasing, writing (selling), and combination strategies, investors and traders would be able to use options on Treasury securities as short and long-term investment vehicles; as viable alternatives to potentially more risky derivative vehicles; and as a hedge against equity, option, or other security positions or against the risks associated with inverse interest rate movements while retaining the opportunity to profit from favorable movements.

The Exchange contends that trading Treasury securities options on the Exchange, as proposed, offers several distinct benefits.[11] First, options on Treasury securities would be traded in a highly regulated and transparent exchange environment. Second, as a result of the standardization of Treasury securities option contracts in conjunction with quoting and market making requirements, such option contracts should develop more liquid and deeper markets. Third, counterparty credit risk would be mitigated because the contracts would be issued and guaranteed by the OCC. And fourth, the quotation and last-sale data provided by the Exchange to the options processor, Options Price Reporting Authority ("OPRA") and its members would lead to more transparent markets. The Exchange believes that expanding the universe of listed products available to market participants interested in Treasury securities options by listing such options on the

[11] The Exchange currently allows the trading of certain options that may reference Treasury Securities. Commentary .09(a)(iv) to Rule 1009 states that securities deemed appropriate for options trading currently include shares or other securities including Fixed Income Index-Linked Securities ("Fixed Income ILS"). Fixed Income ILS are described as securities that provide for the payment at maturity of a cash amount based on the performance or the leveraged (multiple or inverse) performance of one or more notes, bonds, debentures or evidence of indebtedness that include, but are not limited to, U.S. Department of Treasury securities, government-sponsored entity securities, municipal securities, trust preferred securities, supranational debt and debt of a foreign country or a subdivision thereof or a basket or index of any of the foregoing ("Fixed Income Reference Asset").

Exchange could significantly increase competition with other exchanges that have the capability to list and trade derivatives on Treasury securities[12] as well as with the OTC market.[13]

Exchange Rules Are Applicable

The Exchange establishes the controlling principle that its existing rules and procedures are applicable to options on Treasury securities and the proposed rules would supplement existing Exchange rules. Proposed Rule 1000D states that unless otherwise specified, the rules in the 1000D Series are applicable only to options on Treasury securities. The rule states further that except to the extent that specific rules in the 1000D Series govern, or unless the context otherwise requires, the provisions of the Option Rules applicable to equity options[14] and of the By-Laws[15] and all other Rules and Policies of the Board of Directors[16] (together referred to as "current Exchange rules") are applicable to the trading on the Exchange of options on Treasury securities. The Exchange underscores the general controlling principle that current Exchange rules are

---

[12] For example, Chicago Board of Trade ("CBOT") lists futures and options on futures on Treasury securities (and other debt instruments). CBOE lists options on exchange traded funds and other vehicles that are invested in Treasury securities.

[13] Exchange listed options are viewed as a viable, liquid alternative to OTC options. This is, as discussed, because exchange listed options do not possess the negative characteristics often associated with non-exchange listed (OTC) options, such as lack of transparency; counterparty risk; and insufficient regulation, clearing arrangements, collateral requirements, and trade processing. The Exchange/OTC market distinction and the safeguards of central clearing and SRO regulation have become particularly evident and significant in the recent economic downturn.

[14] Option Rules 1000 et seq.

[15] By-Laws Articles I to VII.

[16] Rules of the Exchange Rule 1 et seq. and Options Floor Procedure Advices.

applicable by referring to current option rules in certain proposed Treasury securities options rules.[17]

Treasury securities options will generally trade on the Exchange's electronic options platform, Phlx XL[18] and settle like equity options on the Exchange. As noted, therefore, Exchange rules applicable to equity options trading will be applicable to Treasury securities options unless there is a specific rule in the 1000D Series to the contrary or a proposed rule supplements an existing rule.

Treasury securities options will be physically settled, European-style options that may be exercised only on the day that they expire.[19] Trading in Treasury securities options ordinarily will cease on the business day (usually a Friday) preceding the expiration date. 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.[20]

---

17 For example, proposed Rule 1004D refers to current Rules 1001 regarding position limits, 1003 regarding reporting of options positions, and 1004 regarding liquidation of positions. Proposed Rules 1011D and 1012D refer to current Rule 1047 regarding trading rotations, halts and suspensions. Proposed Rule 1014D refers to current Rule 1014 regarding obligations and restrictions applicable to specialists and Registered Options Traders ("ROTs"; specialists and ROTs are defined in Rules 1020 and 1014 (b)(i), respectively), and Rule 1080 regarding electronic trading via Phlx XL and XL II. Proposed Rule 1015D refers to current Rule 1059 regarding accommodation trading. Proposed Rule 1019D refers to current Rule 1014 regarding obligations and restrictions applicable to specialists and ROTs and 1047 regarding trading halts. Proposed Rule 1020D refers to current Rule 1043 regarding exercise assignment notices. Proposed Rule 1022D refers to Rule 721 regarding margin. Proposed Rule 1023D refers to current Rule 1022 regarding identification of accounts and reports of specialists and ROTs.

18 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).

19 Proposed Rules 1008D(c) and 1026(D)(e).

20 Proposed Rule 1010D. For trading hours on the Exchange, see Rule 101.

The expiration date will be the Saturday immediately following the third Friday of the expiration month.[21]

Definitions

Definitions applicable to Treasury securities and options on them are found in proposed Rule 1001D. Regarding products underlying options to be traded on the Exchange subsection (a)(1) states that "Treasury securities" represent 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 United States has a direct or indirect interest.[22] Next, the terms “bond” and “note” are defined. Subsection (a)(2) of proposed Rule 1001D states that Treasury notes are interest-bearing debt instruments issued by the U.S. Treasury with a term to maturity of at least two years but no more than ten years at the time of original issuance. Subsection (a)(3) states that Treasury bonds are interest-bearing debt instruments issued by the U.S. Treasury with a term to maturity of more than ten years at the time of original issuance.

The Exchange establishes two exercise price definitions in proposed Rule 1001D: exercise price and aggregate exercise price.[23] The Exchange also establishes the concept of a covered short call and put position in Treasury securities options.[24]

---

21 Specifications for options on Treasury securities may be found at www.nasdaqtrader.com.

22 See supra note 3.

23 Subsections (a)(5) and (a)(6) of Rule 1001D, respectively, state: “Exercise price" in respect of a specific cusip option means the specified price at which the underlying Treasury security may be purchased or sold upon the exercise of the option contract. "Aggregate exercise price" in respect of a specific cusip option means the exercise price of an option contract multiplied by the principal amount of the underlying Treasury security covered by the option.

Designation and Commencement of Trading

Treasury securities options will use a convention for describing (designating) options that is uniquely adapted to the nature of such options. Specifically, proposed Rule 1005D states that Treasury options purchased and sold on the Exchange 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. For example, a specific cusip call option expiring in March and having an exercise price of 96 of the $10,000 principal amount of a 3 3/4% Treasury bond that matures on August 15, 2041, would be designated as a Treasury 3 3/4%—8/15/41 March 96 call.

Regarding specific cusip Treasury security options, subsection (a) to proposed Rule 1009D states that at any time after an auction sale of an underlying Treasury

---

24 Subsection (a)(7) of rule 1001D states: The term "covered" in respect of a short position in a Treasury security call option contract means that the writer holds in the same account on a principal for principal basis: (1) a long position in underlying Treasury securities that qualify for delivery upon exercise; (2) a long Treasury securities call option position for the same underlying security as the short call position where the expiration date of the long call position is the same as or subsequent to the expiration date of the short call position and the exercise price(s) of the long call position is equal to or less than the exercise price of the short call position; or (3) a custodial or Treasury securities escrow receipt pursuant to Rule 1022D.

The term "covered" in respect of a short position in a Treasury security put option contract means that the writer holds in the same account on a principal for principal basis: (1) a long Treasury security put option position for the same underlying security as the short put position where the expiration date of the long put position is the same as or subsequent to the expiration date of the short put position and the exercise price(s) of the long put position is equal to or greater than the exercise price of the short put position or (2) a Treasury security put guarantee letter pursuant to Rule 1022D.

security, if the Exchange decides to initially open options for trading the Exchange shall open a minimum of one expiration month and series for each class of options.[25] These series are opened pursuant to the "opening timeframe" concept established in Rule 1006D, which is discussed below.[26] The Exchange notes that while the "opening timeframe" concept is specific to Treasury securities options, the minimum one expiration month and one series requirement is wholly consistent with a similar requirement for other options traded on the Exchange.[27]

Additional series may also be opened when the Exchange deems it necessary to maintain an orderly market, to meet customer demand or to reflect substantial changes in the prices of underlying Treasury securities.[28] These series are opened pursuant to the "additional series" concept established in Rule 1006D. The Exchange will give notice that it is opening any such additional options.[29]

Terms and Criteria for Listing and Trading

The Exchange proposes rules setting forth the initial and continued (maintenance) listing standards for Treasury securities options.

---

25 A single Treasury security option covers $10,000 principal amount of the underlying security. Proposed Rule 1008D.

26 Rule 1012.

27 See Rule 1101A (narrow and broad-based index options).

28 While the "additional series" concept is specific to Treasury securities options, the proposed series add procedure is otherwise similar to the process for adding other option series on the Exchange. See Rule 1012 in respect of equity and ETF options. As discussed, the exercise price of an option must be reasonably close to 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. Proposed Rule 1008D.

29 The Exchange generally provides notice via OTA or the Exchange web site.

Specifically, subsection (a) of proposed Rule 1006D states that 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, aggregate principal amount outstanding, and years to maturity.

Additionally, the following factors must be met:

(1) The original public sale of an underlying Treasury security shall be at least $1 billion principal amount.

(2) The approval of such an underlying Treasury security will ordinarily extend for the current auction of the underlying Treasury security through the end of the final month of such auction ("opening timeframe"), and additional series of options opened thereafter will relate to more recently issued Treasury securities within the opening timeframe ("additional series"). This is done to limit underlying securities for specific cusip options to the most recently issued and actively traded issues.[30]

Proposed Rule 1007D states in subsection (a) that the Board (or a designee of the Board) may determine, for any reason, to withdraw approval of any Treasury securities that were initially approved for options trading pursuant to Rule 1006D as underlying

[30] Provided that, in respect of this second requirement, such approval may be extended in the event of the reopening of the underlying security by the Treasury, or in the event of issues where a reasonably active secondary market exists. Further, even prior to the end of such opening timeframe and additional series, the Board (or a designee of the Board) shall withdraw approval of an underlying Treasury security at any time if it determines on the basis of information made publicly available by the Treasury that the security has a public issuance of less than $750 million, excluding stripped securities. Proposed Rule 1006D(a)(2).

securities.[31] Subsection (b) states that after any announcement by the Exchange of such withdrawal of approval, each member organization shall, if requested by a customer to effect an option transaction in such Treasury securities, inform such customer of the withdrawal of approval prior to affecting any transactions in such securities.

Minimum Price Variation and Bids and Offers

Proposed Rule 1013D discusses minimum increment and the unique meaning of bids and offers for options on Treasury securities. Specifically, subsection (a) provides that Treasury securities options shall have a minimum increment of $.01. Subsection (b) similarly provides that bids and offers for Treasury securities options shall be expressed in $.01 increments. The Exchange believes that the proposed $.01 increments are uniform and particularly appropriate for Treasury securities options to allow traders to make the most effective use of the product for trading and hedging purposes. The Exchange believe further that the proposed $.01 increments will not cause any capacity problems.

Penny increments have been used very effectively for more than five years on the Exchange as well as on other options markets. First, the Commission has approved the use of penny increments pursuant to the Penny Pilot, pursuant to which some of the highest-volume options trade in penny increments for series of options less than $3.00.[32]

---

[31] As with other options products (e.g. equity options, index options), Treasury security options that are no longer approved but have open interest would remain open for closing transactions only so that the open interest can trade out or expire.

[32] These include the highest-volume options overlying the PowerShares QQQ Trust (QQQQ)®, the SPDR S&P 500 Exchange Traded Funds (SPY), and the iShares Russell 2000 Index Funds (IWM) which, unlike other Penny Pilot options, trade at penny increments regardless of the price (the Penny Pilot establishes $.05 increments where the price is $3.00 or higher). See Securities Exchange Act Release No. 55153 (January 23, 2007), 72 FR 4553 (January 31, 2007)(SR-Phlx-

Second, the Commission has approved the use of penny increments for certain categories of products on the Exchange such as, for example, foreign currency options (FCOs, also known as World currency Options or WCOs).[33] Third, the Commission has approved the use of penny increments for specific option products on the exchange such as Alpha Index Options.[34] Fourth, the Commission has approved penny increments for various option products traded on other exchanges.[35] As such, the Exchange believes that penny

---

2006-74)(notice of filing and approval order establishing Penny Pilot); and Rule 1034. All other options exchanges have similar penny pilot programs.

The Exchange notes that the Penny Pilot has structural limitations that make it wholly inappropriate for Treasury securities options. The Penny Pilot is, for example: a) available only for a limited number of equity, index, and ETF options, and all of the available slots are already used; b) designed to be used by other exchanges that have similar pilots to multiply list and trade options, but as noted all other penny pilot markets do not have rules that would allow them to list Treasury securities options; and c) is severely limited in terms of price below $3.00.

33 See Securities Exchange Act Release No. 60169 (June 24, 2009), 74 FR 31782 (July 2, 2009)(SR-Phlx-2009-40)(order approving listing and trading of FCOs or WCOs at penny increments); and Rule 1034.

34 See Securities Exchange Act Release No. 63860 (February 7, 2011), 76 FR 7888 (February 11, 2011)(SR-Phlx-2010-176)(order approving listing and trading Alpha Index Options); and Rule 1034.

35 See Exchange Act Release Nos. 64991 (July 29, 2011), 76 FR 47280 (August 4, 2011)(SR-CBOE-2011-039)(order approving listing and trading single stock dividend options in penny increments); 63352 (November 19, 2010), 75 FR 73155 (November 29, 2011)(SR-CBOE-2011-046)(order approving amendments regarding credit default options, including penny increments); 31169 (May 22, 2008), 73 FR 31169 (May 30, 2008)(SR-CBOE-2006-105)(order approving listing and trading binary options on broad-based securities in penny increments); and 58486 (September 8, 2008), 73 FR 53298 (September 15, 2008)(SR-ISE-2008-36)(notice and filing and immediate effectiveness proposing to permit ISE members to enter non-displayed electronic orders and quotes in penny increments, citing to SR-CBOE-2007-39 and SRNASDAQ-2007-004 and SR-NASDAQ-2007-080). See also NYSE Arca Equities Rule 7.6, Commentary .03, which indicates that the minimum price variation for quoting and entry of orders in

increments are proper for Treasury securities options and represents that it has the necessary system capacity to support any additional Treasury securities option series that are listed pursuant to this proposal.

It is clear that inadequately narrow Treasury securities option intervals negatively impact trading and hedging opportunities.

As an example, if the increments were set at another interval level such as $0.50 instead of the proposed $0.01, and an investor wanted to spend no more than $375 to buy a down-side hedge with a put option on a Treasury bond currently trading 102.00, the investor would have the following strikes available from which to chose: an at-the-money ("ATM") 102 put and an out-of-the-money ("OTM") 101 put. If the bid/ask quote for the ATM 102 put was $350/$400, then the investor may elect not to pay $400 and may subsequently choose the lower OTM 101 put. Even if the resulting 101 put had a bid/ask of $200/$250, thereby allowing the investor to make a purchase for less than $375, the investor would have a different risk/reward scenario because the lower put would not represent an ATM hedge. Accordingly, the investor would have to carry the Treasury bond position with risk of market movement down to the 101 strike before the put becomes an ATM put. If, on the other hand, the proposed $0.01 intervals were effective, and the same investor had a choice of the same strikes from which to choose (an ATM 102 put and an OTM 101 put), at $0.01 intervals the premium cost for a hedge using the ATM 102 put may be about $359 to $360. This would garner the investor as much as a $40 or 10% savings in the cost to put on the desired hedge. The proposed interval range would clearly be very advantageous to investors; and would be costly if not available.

---

equity securities traded on Arca is $.01, with the exception of securities that are priced less than $1.00 for which the MPV for order entry is $0.0001.

And as yet another example, if an investor were interested in purchasing a complex option spread, narrow option intervals would offer additional cost savings and choice. Using the noted 102 and 101 put example, an investor may choose to purchase (go long) a put spread as a hedge; this would be a complex order where the investor would buy the higher strike and simultaneously sell the lower strike for a debit. If the strike price increments were set at $0.50 and an investor wanted to spend no more than $150 to buy a down-side hedge via a long put spread, and the bid/ask of the 102 put was $350/$400 and the 101 put was $200/$250, the premium cost to the investor would be $200 (simultaneous purchase of the 102 put for $400 and sale of the 101 put for $200). However, if the proposed $0.01 intervals were effective, and an investor wanted to spend no more than $150 to buy a down-side hedge via a long put spread, and the bid/ask of the 102 put was $359/$360 and of the 101 put was $220/$221, the premium cost would be $140 (simultaneous purchase of the 102 put for $360 and sale of the 101 put for $220). This would garner the investor as much as a $60 or 30% savings in the cost to put on the desired hedge. The proposed interval range would clearly be very advantageous to investors; and would be costly if not available.[36]

Proposed Rule 1014D sets forth that current Rule 1014 is applicable to Treasury securities options. Rule 1014 sets for obligations and restrictions applicable to specialists and ROTs and discusses, among other things, market making obligations, quoting obligations and parameters, and priority. Proposed Rule 1014D also sets forth that Rule 1080 is applicable to Treasury securities options. Rule 1080 discusses the operation of

---

36 The Exchange notes that in that Treasury security option positions could be quite large because the underlying instruments would be in $10,000 denominations, the percentage savings discussed in the examples could be very significant.

Phlx XL and XL II, which are the Exchange's electronic platform in respect of orders, execution and trades. The Exchange specifically notes Rules 1014 and 1080 in proposed Rule 1014D because of the applicability to Treasury securities options trading of fundament trading-related matters in Rules 1014 and 1080 such as, for example, market making and quoting obligations, priority, and electronic trading.

The Exchange likewise proposes Rule 1019D regarding maximum bids and offers that may be maintained by specialists and ROTs in options on Treasury securities. This rule states that without limiting the general obligation to deal for his account as stated in Rule 1014,[37] a specialist or ROT holding an appointment in Treasury securities options is expected, in the course of maintaining a fair and orderly market, to bid and/or offer so as to create differences of:

(1) no more than $0.25 between the bid and offer for each option contract for which the bid is less than $1;

(2) no more than $0.50 where the bid is $1 or more but less than $5;

(3) no more than $0.80 where the bid is $5 or more but less than $10 ; and

(4) no more than $1 where the bid is $10 or more.[38]

---

37 Rule 1014 is, similarly to the relationship between current and proposed rules in the filing, supplemented by proposed Rule 1019D. While bid/ask (offer) differentials are set forth for other (non-Treasury securities) options in Rule 1014, specific bid/ask (offer) differentials are set forth for Treasury securities options in proposed Rule 1014D. This is in line with the principle that while current options trading rules (e.g. 1014 and 1080) are applicable to Treasury securities options, certain rules specifically tailored to Treasury securities options trading are promulgated in this proposal.

38 This is similar to the structure for maximum bids and offers for equity, index, and FCO (WCO) options on the Exchange. See Rule 1014(c).

Subsection (b) of Rule 1019D states that for all longer term series the maximum bid/ask differentials are double those listed in subsection (a). This subsection states further that the differentials apply only to the two nearest term series of each class of Treasury security options. The Exchange notes that the proposed increments and maximum bid/ask variations are designed to allow the Exchange flexibility to list options with strike increments at appropriate levels, while diminishing any potential adverse effect on the Exchange's quote capacity thresholds. The Exchange believes that the operational capacity used to accommodate the trading of Treasury securities options on the Exchange will have a negligible effect on the total capacity used by the Exchange to trade its products on a daily basis.

Expiration and Exercise

Proposed Rule 1008D discusses expiration and exercise price in respect of Treasury securities options. Subsection (a) states that a single Treasury security option covers $10,000 principal amount of the underlying security. The expiration month and exercise price of Treasury security options of each series shall be determined by the Exchange at the time each series of options is first opened for trading.[39]

Subsection (b) provides that Treasury security options opened for trading on the Exchange will expire on a monthly basis, none further out than the opening timeframe and additional series as defined in Rule 1006D.[40] Subsection (c) provides that Treasury security options may be exercised only on the day that they expire. The subsection

[39] When opening a Treasury security option for trading, the Exchange will open at least one series and one month. Subsection (a) to proposed Rule 1009D.

[40] But cf. CBOE Rule 21.8(b), which allows the CBOE board (or a designee of the board) to provide alternate expiration cycles after notifying traders of Treasury security options.

provides further that the exercise price of each series of Treasury security options shall be fixed at a price denominated in $0.50. In the case of a specific cusip Treasury security option, 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.[41] The proposed rule also states that the exercise price of additional series will ordinarily be fixed at a multiple of $0.50.[42]

Proposed Rule 1020D discusses exercise assignment notices in the case of Treasury securities options. Subsection (a) states that the method of allocation of exercise notices established pursuant to Rule 1043 may provide that an exercise notice of block size[43] shall be allocated to a customer or customers having an open short position of block size; and that an exercise notice of less than block size shall not be allocated, to the extent feasible, to a customer having a short position of block size. In the case of call

---

41 The Exchange believes that in light of the potential volatility in bond prices, the proposed 20% exercise price band around the underlying is quite reasonable. See, e.g., Commentary .06 to Rule 1012 establishing a 20% volatility band (20% above and 20% below) for currency options (FCOs or WCOs).

42 The Exchange notes that relatively small portions of a dollar, such as for example a quarter or less, may have a significant effect on exercise prices of positions held by traders and public customers because of the large size of the underlying Treasury securities options. The Exchange notes further that futures on similar Government securities, with which the proposed Treasury securities options would compete, enjoy intervals that are as small as one sixty-fourth of a point (dollar).

To minimize the proliferation of strikes, however, the Exchange is proposing somewhat larger $0.50 intervals for Treasury securities option exercise strike prices.

43 For the purposes of this Rule, an exercise notice or a short position in a series of options where the total principal amount is $1 million or more and where the underlying security is a Treasury security shall be deemed to be of "block size." Subsection (c) of Rule 1020D.

option contracts, subsection (b) states that a member organization shall allocate an exercise notice to a customer who has made a specific deposit of the underlying security if it is directed to do so by the OCC.

Settlement and Delivery / Payment

Options on Treasury securities will be physically settled and, being European style options, may be exercised only on the expiration date. The settlement process for Treasury securities options will be the same as the settlement process for equity options under current Exchange rules (e.g. Rule 1044).

Subsection (a) to proposed Rule 1021D states, in respect of delivery and payment of options on Treasury securities, that payment of the aggregate exercise price in the case of specific cusip options must be accompanied by payment of accrued interest on the underlying Treasury security. The interest will be from (but not including) the last interest payment date to (and including) the exercise settlement date as specified in the rules of the OCC.

Position Limits

In determining position limit compliance, proposed Rule 1002D establishes initial and maintenance position limits unique to options on Treasury securities.

Regarding initial position limits, subsection (a) of proposed Rule 1002D provides that the options shall be subject to a contract limitation (whether long or short) of the put type and the call type on the same side of the market covering a value no greater than 7.5% of the value of the initial or reopened public issuance, rounded to the next lower $100 million interval. For purposes of this position limit, there will be a combining of long positions in put options with short positions in call options, and short positions in put options with long positions in call options; or such other lower amount of options as fixed from time to time by the Exchange as the position limit for one or more classes or series of options. Subsection (a)(1) provides that in no event shall the position limit exceed a position on either side of the market covering a value in excess of $750,000,000 of the underlying securities. Subsection (a)(2) requires that the Exchange provide reasonable notice of each new position limit fixed by the Exchange, by notifying members thereof via OTA.

To calculate the proposed $750,000,000 position limit proposed in Rule 1002D, the Exchange is using Position Accountability Levels ("Accountability Levels" or "limits") for Treasury futures and options on such futures on CBOT as the starting basis. Unlike the current situation on options markets, where there is no active trading of Treasury derivatives, CBOT has the most active markets in the U.S. for trading listed futures on Treasuries and options on such futures. The current CBOT Accountability levels, which effectively serve as position limits on CBOT Treasury derivatives,[44] are the equivalent of dollar position limits with a notional value of $2,500,000,000 for options on futures and $1,000,000,000 for futures on Treasury bonds traded on CBOT; and $2,000,000,000 for options on futures and $750,000,000 for futures on Treasury notes traded on CBOT.[45] The Exchange is using these notional position limit values as a starting point to which it applies a conservative methodology to arrive at a proposed

---

44 See http://www.cmegroup.com/rulebook/files/CBOTChapter5_InterpretationClean.pdf.

45 The dollar equivalent position limit value for options on Treasury bonds traded on CBOT, as an example, is calculated as follows: 25,000 share CBOT Accountability Level x CBOT Treasury option face value of $100,000 x Phlx option on Treasury security face value of $10,000 = $2,500,000,000.

$750,000,000 proposed position limit in Rule 1002D for options on Treasury securities traded on the Exchange. First, the Exchange is using the CBOT futures Accountability limit for Treasury bonds (notional value of $1,000,000,000) to establish the proposed position limit for options on Treasury securities. This is because CBOT futures on Treasuries, rather than CBOT options on such futures, are arguably more similar to Exchange options on Treasury securities.[46] Second, the Exchange is then applying a 25% haircut to the $1,000,000,000 notional value for CBOT Treasury futures. This is because Exchange options on Treasury securities would settle into a single cusip Treasury security while CBOT Treasury futures and options settle into the cheapest to deliver Treasury security. And third, when compared to CBOT Treasury options on notes the proposed $750,000,000 position limit for Exchange options on Treasury securities is more that 60% lower that the position limit for CBOT Treasury options on futures (notional value of $2,000,000,000).[47]

The Exchange believes that its very conservative proposed nominal dollar position limit, in conjunction with the proposed equally conservative 7.5% of the value of the initial or reopened public issuance,[48] will minimize (negate) potential manipulation and fraudulent activity in Treasury options.[49]

---

46 CBOE Treasury futures will, like Exchange options on Treasury securities, settle into the underlying Treasury notes or bonds; CBOT options on Treasury futures, on the other hand, will settle into the underlying derivative instruments (futures).

47 The proposed $750,000,000 position limit for Exchange options on Treasury securities approximates the notional position limit for CBOT Treasury futures on notes.

48 Upon examining U.S. Treasury record setting auction data at http://www.treasurydirect.gov/instit/annceresult/auctdata/auctdata_statdata.htm, which has “Highest Offering Size” for Treasury bonds and notes, the Exchange believes that the proposed 7.5% limit is quite conservative. For example, if the

Regarding maintenance of position limits for Treasury securities options, subsection (b) of proposed Rule 1002D provides that in the event that any of the underlying Treasury securities are reported as "separate trading of registered interest and principal of securities" ("strips") in the Monthly Statement of the Public Debt of the United States Government, or such other report or compilation as may be selected from time to time by the Exchange, such stripping shall be taken into account in determining whether the position limit as initially established under paragraph (a) ("the established position limit") can be maintained (the remaining non-stripped underlying securities are hereinafter referred to as "the non-stripped securities").

Subsection (b)(1) states that the established position limit may remain so long as the position limit covers a principal amount of underlying securities not in excess of 7.5% of the non-stripped securities. However, in the event that the established position limit covers a principal amount of securities in excess of 7.5% of the non-stripped securities, the Exchange shall reestablish the position limit to cover a principal amount of

---

7.5% maximum were applied to the "Highest Offering Size" for the 30 Year Treasury Bonds, which was $16,000,000,000 on November 12, 2009 (and was $44,000,000,000 for 2-year Treasury notes), the maximum value would be $1,200,000,000. By establishing the proposed, substantially lower position limit of 7.5% and $750,000,000, the Exchange has put into place a mechanism that guards against achieving higher automatic positions limits in all Treasury bonds and notes, including the higher offering size 2-year Treasury notes.

49 The Exchange also notes that its proposed position limits are significantly smaller that the position limits that were approved by the Commission decades ago for trading Treasury options on CBOE. See CBOE Rule 21.3(a), which states, in relevant part that: …Options on a Treasury security shall be subject to a contract limitation (whether long or short) of the put type and the call type on the same side of the market covering a value no greater than 10% of the value of the initial or reopened public issuance, rounded to the next lower $100 million interval…In no event shall the position limit exceed a position on either side of the market covering a value in excess of $1,200,000,000 of the underlying securities.

underlying securities not in excess of 7.5% of the non-stripped securities.[50] Subsection (2) provides that except as otherwise exempted under Exchange rules, persons whose positions exceed revised position limits may only engage in liquidating transactions until their positions are lower than the revised position limits.

By virtue of proposed Rule 1003D, exercise limits for options on Treasury securities are equivalent to position limits on these instruments. This is similar to the relationship of position and exercise limits for equity and other options pursuant to current Exchange rules.[51]

Moreover, proposed Rule 1004D states that for purposes of Rules 1003 and 1004,[52] references to Rule 1001 in connection with position limits shall be deemed, in the case of Treasury securities options, to be to Rule 1002D. The proposed rule states further that the reference in Rule 1003(a) to reports required of positions of 200 or more options shall, in the case of Treasury securities options, be revised to positions of options covering $2 million or more principal amount of underlying Treasury securities, for example, the 3.125% bonds due in the year 2042.

Margin

The current procedure for establishing margin on the Exchange is in Rule 721. The rule states that member organizations must elect whether they will follow CBOE or New York Stock Exchange ("NYSE") equity option margin rules, notify the Exchange of

---

[50] Such revisions will become effective the Monday following the provision of notice thereof via OTA.

[51] See Rules 1001 and 1002 (equity, ETF, currency options) and Rules 1001A and 1002A (index options).

[52] Rule 1003 deals with reporting of options positions and Rule 1004 deals with liquidation of options positions.

the election, and comply with the applicable rules.[53] The Exchange proposes to amend Rule 721(b) to state that upon the filing of such election, a member organization engaged in trading Treasury securities options on the Exchange shall, in respect of such trading, comply with the CBOE or NYSE equity option margin rules, as applicable. For clarification purposes, the Exchange specifically states in Rule 721 that CBOE or NYSE Treasury options margin rules are not to be used by member organizations that trade Treasury security options.

Proposed Rule 1022D states that Exchange member organizations shall comply with the initial and maintenance margin requirements as set forth in Rule 721. Thus, by operation of proposed Rule 1022D, member organizations involved in trading Treasury security options will be bound by the same CBOE or NYSE equity options margin rules that the member organizations choose for other margin purposes. The Exchange believes that this proposed margin procedure is appropriate for Treasury securities options. First, it ensures consistency in that member organizations must consistently follow the margin rules of either CBOE or NYSE according to their written margin rules election per Rule 721. Second, it is operationally and systemically efficient in that member organizations can immediately apply the margin procedures that they use for equity margin to the proposed new Treasury securities options, and the Exchange can use established margin surveillance processes, thereby reducing the potential for error from all perspectives. And third, the current equity margin rules of CBOE are, without a doubt, more up to date

---

[53] See Rule 721(b). Moreover, the rules states that the election shall be promptly made in writing by a notice filed with the Exchange; and that each member organization shall be bound to comply with the margin rules of CBOE or NYSE, as applicable, as though said rules were part of the Exchange's Margin Rules.

and usable in today's fast-paced hybrid and electronic trading environment than the decades-old CBOE Treasury option margin rules.[54]

Doing Business with the Public

Proposed rule 1025D sets up guidelines dealing with customer account approval and supervisory qualification. Subsection (a) states that approval of the accounts of customers shall be conducted in accordance with Rule 747[55] and, in the case of institutional options customers (i.e., customers that are not natural persons), a member organization shall seek to obtain the following information:

(1) evidence of authority for the institution to engage in Treasury securities options transactions (corporate resolutions, trust documents, etc.);

(2) written designation of individuals within the institution authorized to act for it in connection with Treasury securities options transactions; and

(3) basic financial information concerning the institution.

Subsection (b) states that as a general matter, supervisory qualifications of a Registered Options Principal may be demonstrated only by successful completion of an examination prescribed by the Exchange (e.g. Series 4) for the purpose of demonstrating an adequate knowledge of Treasury securities options and the underlying Treasury

---

54 As an example, CBOE margin rules applicable to equity options have transaction/position specific procedures in CBOE Rule 12.3 as well as modern portfolio margin procedures in CBOE 12.4. Moreover, the Exchange notes that like CBOE, the OCC has portfolio margin procedures and extensive margin rules germane to clearing Treasury security options.

55 Rule 747, which is applicable to all Exchange member organizations, among other things indicates that prior to making any brokerage transaction for the account of a customer, the opening of a customer account must have been properly approved.

securities.[56] Subsection (c) states that the conduct of Treasury securities option business at a branch office of a member organization may be supervised by any Registered Options Principal of the member organization. Subsection (d) states that any sales personnel of a member organization who solicit or accept customer orders with regard to options on Treasury securities shall be deemed qualified with regard to such options after such personnel successfully completed an examination prescribed by the Exchange for the purpose of demonstrating adequate knowledge of options and the underlying Treasury securities.

Other Trading-Related Rules

The Exchange proposes additional trading-related rules for Treasury securities options that are similar to certain rules that are applicable to equity and other options. Proposed Rule 1018D states that a limit order book will be available for Treasury securities options. Proposed Rule 1015D states that accommodation trading under the applicable terms and conditions of Rule 1059 will be available in each series of Treasury securities option contracts open for trading on the Exchange. However, bids or offers for opening transactions at a price of $1 per option contract may be executed only with closing transactions that cannot at that time in open outcry be executed with another closing transaction. Proposed Rule 1016D states that all members, member firms, and clearing members shall resolve unmatched trades in Treasury security options from the previous day's trading no later than 9:00 a.m. (Eastern Time) of the following business day. And proposed Rule 1024D permits members to establish and maintain

---

56 In exceptional circumstances and where good cause is shown, however, the Exchange may, upon written request by a member organization, accept as a demonstration of equivalent knowledge other evidence of a Registered Options Principal's supervisory qualifications.

communication links with other members for the purpose of obtaining timely information on price movements in Treasury securities on which options are dealt in on the Exchange.

Proposed Rule 1023D sets forth procedures regarding furnishing of books, records, and other information to the Exchange. Subsection (a) provides that no specialists or ROTs in Treasury securities options shall fail to make available to the Exchange books, records or other information[57] as may be called for under the rules or as may be requested in the course of any investigation, any inspection or other official inquiry by the Exchange. In addition, the provisions governing identification of accounts and reports of orders shall, in the case of specialist or ROTs in Treasury securities options, apply to (i) accounts for Treasury securities deliverable under the terms of the option contracts involved, Treasury securities futures, options on Treasury securities futures and Treasury securities options trading; and (ii) orders entered by the specialist or ROT for the purchase or sale of Treasury securities deliverable under the terms of the options contracts involved, Treasury securities futures, options on Treasury securities futures, options on Treasury securities and opening and closing positions therein. Also, subsection (b) states that any corporate affiliate of a specialist or ROT in Treasury securities options shall maintain and preserve such books, records or other information as may be necessary to comply with this rule.

Proposed Rule 1011D states that Rules 1047 and 1092 are applicable to Treasury securities options. Rule 1047 governs trading halts, rotations and suspensions, and Rule 1092 governs obvious errors and catastrophic errors for equity (and other) options traded

57 More specifically, such books, records, or information as maintained by or in the possession of such member or any corporate affiliate of such member pertaining to transactions by such member or any such affiliate for its own account in Treasury securities, Treasury securities futures or in Treasury securities options.

on the Exchange. Proposed Rule 1012D(a) states that in addition to the factors set forth in Rule 1047, a factor that may be considered by Options Exchange Officials in connection with the institution of trading halts is that current quotations for the underlying Treasury securities are unavailable or have become unreliable; or that there is a need to prevent an unfair and disorderly market.[58]

Proposed Rule 1012D(b) states that Rule 1092 error procedures shall be applicable to Treasury securities options. The Exchange proposes to amend Rule 1092(a) to state, for purposes of conformity, that Treasury security options will have the same obvious error thresholds as equity and index options.[59] The Exchange believes that the proposed

---

58 For example, where the underlying Treasuries are still trading, there may be a severe anomaly in the Treasury options market caused by, for example, by an extreme price move in the equities market which triggers a circuit breakers and halts equity and other trading for a period of time.

59 The proposed new language in Rule 1092(a) will add, regarding Treasury securities options, that for purposes of the rule an Obvious Error will be deemed to have occurred when the execution price of a transaction is higher or lower than the Theoretical Price for a series by an amount equal to at least the amount shown below:

For Treasury securities options

Theoretical price	Minimum amount
Below $2	$.25
$2 to $5	$.40
Above $5 to $10	$.50
Above $10 to $20	$.80
Above $20	$1.00

obvious error threshold, being similar to equity and index options thresholds, will promote consistency and predictability for traders; and that the thresholds are proper in light of the expected trading Treasury options trading ranges.[60] The Exchange also proposes to amend Rule 1092(c)(iv)(D) to state that, similarly to equity options, treasury security option trades on the Exchange will be nullified when the trade occurred during a trading halt of the underlying Treasury security instituted by the United States Government. Unlike other exchange-traded options products that have a primary market for the underlying security (for example, equity options and index options), there is no similar primary market for underlying Treasury securities that are traded over the counter. As such, a Treasury security options trading halt would be based on a trading halt of the underlying Treasury security instituted by the United States Government.[61]

Surveillance

The Exchange will implement surveillance systems that are being used for equity, ETF, currency, and index options to monitor trading in Treasury securities options. This will include, but not be limited to, monitoring for insider trading, manipulation, front-running, and capping and pegging. The Exchange will also monitor public media for rating downgrades and other relevant actions to ensure that the Exchange's maintenance standards are fulfilled, and will monitor for any material actions that may influence the pricing of Treasury securities and options thereon.

---

60 Moreover, the Exchange notes that as with any new product, the Exchange will adjust the Treasury options obvious error rule based on experiential need.

61 As discussed, a Treasury securities option trading halt may also be instituted to prevent an unfair and disorderly market.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act[62] in general, and furthers the objectives of Section 6(b)(5) of the Act[63] 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 implementing new rules allowing the Exchange to list options on Treasury debt securities and allow trading thereon.

The Exchange believes that the proposed rules for listing and trading Treasury securities options, including options on Treasury notes and bonds, are reasonable and consistent with the Act. The Exchange believes that its proposal would enhance competition and provide access to an additional trading and investing vehicle so that traders and large, institutional, retail, and public investors could more effectively and closely tailor their investing and hedging decisions.

The Exchange has proposed rules that are specifically tailored for trading Treasury security options. Pursuant to these proposed rules, the underlying Treasury securities may be approved as appropriate for listing options subject to requirements as to size of original issuance, aggregate principal amount outstanding, years to maturity or other characteristics as the Exchange may deem necessary or appropriate in the interest of maintaining a fair and orderly market or for the protection of investors. The proposed position limits, exercise limits, margin rules, and other rules, in conjunction with the

---

62 15 U.S.C. 78f(b).

63 15 U.S.C. 78f(b)(5).

current Exchange rules, are particularly tailored for Treasury securities options, reasonable, and consistent with the Act. In particular, the proposed position and exercise limits reasonably balance the promotion of a free and open market for these securities with minimization of incentives for market manipulation and insider trading; and the proposed margin rules are reasonably designed to deter a member or its customer from assuming an imprudent position in Treasury securities options.

For these and previously-noted reasons, the Exchange believes that the proposal to allow the Exchange to list and permit trading of Treasury securities options would enhance competition and provide access to valuable additional trading and investing vehicles. These would allow traders and investors - including large and institutional investors and retail and public investors - to more effectively tailor their investing and hedging decisions in the current challenging economic climate.

B. Self-Regulatory Organization's Statement on Burden on Competition

Phlx 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. To the contrary, the Exchange believes that its proposal is pro-competitive. The proposal will allow a new and innovative options product to be listed and traded on the Exchange. This will give market participants the ability to significantly expand their trading and hedging capabilities.

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 45 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 Exchange consents, the Commission shall: (a) by order approve or disapprove 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-2012-82 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-2012-82. 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 website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, 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-2012-82 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.[64]

Kevin M O'Neill
Deputy Secretary

---

[64] 17 CFR 200.30-3(a)(12).

EXHIBIT 5

Proposed new text is <u>underlined</u>. Proposed deletions are [bracketed].

Phlx Option Rules

* * * * *

Rule 721. Proper and Adequate Margin

(a) No Change.

(b) A member organization must elect to be bound by the initial and maintenance margin requirements of either the Chicago Board Options Exchange ("CBOE") or New York Stock Exchange ("NYSE") as the same may be in effect and amended from time to time.

(1) Such election shall be promptly made in writing by a notice filed with the Exchange.

(2) Upon the filing of such election, a member organization shall be bound to comply with the margin rules of CBOE or NYSE, as applicable, as though said rules were part of the Exchange's Margin Rules.

<u>(A) Upon the filing of such election, a member organization engaged in trading Treasury securities options on the Exchange shall, in respect of such trading, comply with the CBOE or NYSE equity option margin rules of CBOE or NYSE, as applicable (not CBOE or NYSE Treasury option margin rules).</u>

(c) – (d) No Change.

* * * * *

Rule 1092. Obvious Errors and Catastrophic Errors

The Exchange shall either nullify a transaction or adjust the execution price of a transaction that results in an Obvious Error as provided in this Rule.

(a) (i) *Definition of Obvious Error*. For purposes of this Rule only, an Obvious Error will be deemed to have occurred when the execution price of a transaction is higher or lower than the Theoretical Price for a series by an amount equal to at least the amount shown below:

For equity and index options

Theoretical price	Minimum amount
Below $2	$.25
$2 to $5	$.40

For equity and index options

Theoretical price	Minimum amount
Above $5 to $10	$.50
Above $10 to $20	$.80
Above $20	$1.00

For foreign currency options

Theoretical price	Minimum amount
Below $2	$.25
$2 to $5	$.40
Above $5 to $10	$.50
Above $10 to $20	$.80
Above $20	$1.00

For Treasury securities options

Theoretical price	Minimum amount
Below $2	$.25
$2 to $5	$.40
Above $5 to $10	$.50
Above $10 to $20	$.80
Above $20	$1.00

(ii) No Change.

(b) No Change.

(c) Absent Mutual Agreement as provided in Rule 1092(c)(iii) below, parties to a trade may have a trade nullified or its price adjusted if:

(i) – (iii) No Change.

(iv) Trading Halts. Trades on the Exchange will be nullified when:

(A) The trade occurred during a trading halt in the affected option on the Exchange;

(B) Respecting equity options (including options overlying ETFs), the trade occurred during a trading halt on the primary market for the underlying security; [or]

(C) Respecting index options, the trade occurred during a trading halt on the primary market in (y) underlying securities representing more than 10 percent of the current index value for stock index options, or (z) either component security of an Alpha Index for Alpha Index options[.]; or

(D) Respecting Treasury security options, the trade occurred during a trading halt of the underlying Treasury security instituted by the United States Government.

(v) No Change.

(d) - (g) No Change.

Commentary: ------------------

.01 - .02 No Change.

* * * * *

Rules Applicable to Trading of Options on Treasury Securities (Rules 1000D—1026D)

Rule 1000D. Applicability of 1000D Series –Treasury Securities Options

Unless otherwise specified, the rules in this 1000D Series are applicable only to options on Treasury Securities of the United States Government (“Government”) as defined below (Treasury securities”). These rules apply to all options on Treasury securities that are notes or bonds, as defined. Except to the extent that specific rules in this Series govern, or unless the context otherwise requires, the provisions of the Option Rules applicable to options and of the By-Laws and all other Rules and Policies of the Board of Directors shall be applicable to the trading on the Exchange of options on Treasury securities.

Rule 1001D. Definitions – Treasury Securities Options

(a) The following terms as used in the Rules in this Series shall, unless the context otherwise indicates, have the meanings herein specified regarding options on Treasury securities.

(1) *Treasury Securities* - The term "Treasury securities" (also known as Treasury debt securities) means 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 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 United States Treasury).

(2) *Treasury note* - The term "Treasury note" means a note issued by the U.S. Treasury with a term to maturity of at least two years but no more than ten years at the time of original issuance.

(3) *Treasury bond* - The term "Treasury bond" means a bond issued by the U.S. Treasury with a term to maturity of more than ten years at the time of original issuance.

(4) *Specific cusip option* - The term "specific cusip option" means an option having a specifically identified underlying Treasury security, which is required to be delivered upon exercise.

(5) *Exercise Price* - The term "exercise price" in respect of a specific cusip option means the specified price at which the underlying Treasury security may be purchased or sold upon the exercise of the option contract.

(6) *Aggregate Exercise Price* - The term "aggregate exercise price" in respect of a specific cusip option means the exercise price of an option contract multiplied by the principal amount of the underlying Treasury security covered by the option.

(7) *Covered* - The term "covered" in respect of a short position in a Treasury securities call option contract means that the writer holds in the same account on a principal for principal basis: (1) a long position in underlying Treasury securities that qualify for delivery upon exercise; (2) a long Treasury securities call option position for the same underlying security as the short call position where the expiration date of the long call position is the same as or subsequent to the expiration date of the short call position and the exercise price(s) of the long call position is equal to or less than the exercise price of the short call position; or (3) a custodial or Treasury securities escrow receipt pursuant to Rule 1022D. The term "covered" in respect of a short position in a Treasury securities put option contract means that the writer holds in the same account on a principal for principal basis: (1) a long Treasury securities put option position for the same underlying security as the short put position where the expiration date of the long put position is the same as or subsequent to the expiration date of the short put position and the exercise price(s) of the long put position is equal to or greater than the exercise price of the short put position or (2) a Treasury securities put guarantee letter pursuant to Rule 1022D.

Rule 1002D. Position Limits – Treasury Securities Options

(a) *Establishment of Position Limit.* In determining position limit compliance, options on a Treasury security shall be subject to a contract limitation (whether long or short) of the put type and the call type on the same side of the market covering a value no greater than 7.5% of the value of the initial or reopened public issuance, rounded to the next lower

$100 million interval, combining for purposes of this position limit long positions in put options with short positions in call options, and short positions in put options with long positions in call options, or such other lower amount of options as may be fixed from time to time by the Exchange as the position limit for one or more classes or series of options.

(1) In no event shall the position limit exceed a position on either side of the market covering a value in excess of $750,000,000 of the underlying securities.

(2) Reasonable notice shall be given of each new position limit fixed by the Exchange, by notifying members thereof via Options Trader Alert ("OTA").

(b) *Maintenance of Position Limit.* In the event that any of the underlying Treasury securities are reported as "separate trading of registered interest and principal of securities" ("strips") in the Monthly Statement of the Public Debt of the United States Government, or such other report or compilation as may be selected from time to time by the Exchange, such stripping shall be taken into account in determining whether the position limit as initially established under paragraph (a) ("the established position limit") can be maintained (the remaining non-stripped underlying securities are hereinafter referred to as "the non-stripped securities").

(1) The established position limit may remain so long as the position limit covers a principal amount of underlying securities not in excess of 7.5% of the non-stripped securities. In the event that the established position limit covers a principal amount of securities in excess of 7.5% of the non-stripped securities, the Exchange shall reestablish the position limit to cover a principal amount of underlying securities not in excess of 7.5% of the non-stripped securities. Revisions to the position limits as provided herein will become effective the Monday following the provision of notice thereof via OTA.

(2) Except as otherwise exempted under Exchange rules, persons whose positions exceed revised position limits may only engage in liquidating transactions until their positions are lower than the revised position limits.

Rule 1003D. Exercise Limits – Treasury Securities Options

In determining exercise limit compliance, the exercise limits for options on a Treasury security shall be equivalent to the position limits prescribed in Rule 1002D.

Rule 1004D. Reports Related to Position Limits and Liquidation of Positions – Treasury Securities Options

For purposes of Rules 1003 and 1004, references to Rule 1001 in connection with position limits shall be deemed, in the case of Treasury securities options, to be to Rule 1002D. The reference in Rule 1003(a) to reports required of positions of 200 or more options shall, in the case of Treasury securities options, be revised to positions of options covering $20 million or more principal amount of underlying Treasury securities, for example, the 3.125% bonds due in the year 2042.

Rule 1005D. Designation of Treasury Securities Options

Treasury securities options dealt in on the Exchange are 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 or nominal exercise price, type (put or call), stated or nominal rate of interest and stated date of maturity or nominal term to maturity (e.g. a specific cusip call option expiring in March and having an exercise price of 96 of the $10,000 principal amount of a 3 3/4% Treasury bond that matures on August 15, 2041, is designated as a Treasury 3 3/4%—8/15/41 March 96 call.

Rule 1006D. Criteria for Securities Underlying Treasury Securities Options

(a) Treasury securities may be approved by the Exchange as underlying securities for Exchange transactions in specific cusip options, subject to such requirements as to size of original issuance, aggregate principal amount outstanding, and years to maturity.

(1) The original public sale of an underlying Treasury security shall be at least $1 billion principal amount.

(2) In order to limit underlying Treasury securities for specific cusip options to the most recently issued and actively traded issues, ordinarily the approval of such an underlying security will only extend for the current auction of the underlying Treasury security through the end of the final month of such auction ("opening timeframe"), and additional series of options opened thereafter will relate to more recently issued Treasury securities within the opening timeframe ("additional series"); provided, however, that such approval may be extended in the event of the reopening of the underlying security by the Treasury, or in the event of issues where a reasonably active secondary market exists; and provided further, that even prior to the end of such opening timeframe and additional series, the Board (or a designee of the Board) shall withdraw approval of an underlying Treasury security at any time if it determines on the basis of information made publicly available by the Treasury that the security has a public issuance of less than $750 million, excluding stripped securities.

Rule 1007D. Withdrawal of Approval of Underlying Treasury Securities or Options

(a) The Board (or a designee of the Board) may determine, for any reason, to withdraw approval of any Treasury security that was initially approved for options trading pursuant to Rule 1006D as underlying securities.

(b) After any announcement by the Exchange of any such withdrawal or approval, each member organization shall, if requested by a customer to effect an option transaction in such Treasury securities, inform such customer of the withdrawal of approval prior to affecting any transactions in such securities.

Rule 1008D. Terms of Treasury Securities Options

(a) *General.* A single Treasury security option covers $10,000 principal amount of the underlying security. The expiration month and exercise price of Treasury security options of each series shall be determined by the Exchange at the time each series of options is first opened for trading.

(b) *Expiration Months.* Treasury security options will expire on a monthly basis, none further out than the opening timeframe and additional series as defined in Rule 1006D.

(c) *Exercise.* Treasury security options may be exercised only on the day that they expire. The exercise price of each series of Treasury security options shall be fixed at a price denominated in $0.50. In the case of a specific cusip Treasury security option, the exercise price so determined shall be reasonably close to, and no more than 20% higher or lower than, 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. The exercise price of such additional series will ordinarily be fixed at a multiple of $0.50.

Rule 1009D. Series of Treasury Securities Options Open for Trading

(a) *Initial Series of Specific Cusip Options.* The Exchange may open for trading specific cusip Treasury security options at any time following the auction sale of the underlying security. At the time options are initially opened for trading on a newly auctioned underlying Treasury security, the Exchange shall open a minimum of one expiration month and series for each class of options open for trading, pursuant to the requirements of Rule 1006D.

(b) *Additional Series of Options to Reflect Price Changes.* After a class of specific coupon Treasury security options has been opened for trading in accordance with paragraph (a) of this Rule, additional series of options of the same class may be opened when the Exchange deems it necessary to maintain an orderly market, to meet customer demand or to reflect substantial changes in prices of the underlying Treasury securities, pursuant to the requirements of Rule 1006D.

Rule 1010D. Days and Hours of Business of Treasury Securities Options

Hours during which Treasury securities options transactions may be made on the Exchange shall correspond to the hours during which equity options are normally traded.

Rule 1011D. Trading Rotations – Treasury Securities Options

Rule 1047 regarding trading rotations, halts and suspensions shall be applicable to Treasury securities options.

Rule 1012D. Trading Halts and Suspension of Trading, Obvious and Catastrophic Errors – Treasury Securities Options

(a) Trading Halts and Suspension of Trading. In addition to the factors set forth in Rule 1047, a factor that may be considered by Options Exchange Officials in connection with the institution of trading halts is that current quotations for the underlying Treasury securities are unavailable or have become unreliable; or that there is a need to prevent an unfair and disorderly market.

(b) Errors. Rule 1092 regarding obvious errors and catastrophic errors shall be applicable to Treasury securities options.

Rule 1013D. Minimum Increment and Meaning of Premium Bids and Offers for Treasury Securities Options

(a) Treasury securities options shall have a minimum increment of $.01.

(b) Bids and offers for Treasury securities options shall be expressed in $.01 increments.

Rule 1014D. Specialist and Registered Option Trader Obligations and Electronic Trading – Treasury Securities Options

Rule 1014 regarding obligations and restrictions applicable to specialists and registered options traders and Rule 1080 regarding Phlx XL and XL II shall be applicable to Treasury securities options.

Rule 1015D. Accommodation Trading - Treasury Securities Options

Accommodation trading under the applicable terms and conditions of Rule 1059 shall be available in each series of Treasury securities option contracts open for trading on the Exchange. However, bids or offers for opening transactions at a price of $1 per option contract may be executed only with closing transactions that cannot at that time in open outcry be executed with another closing transaction.

Rule 1016D. Reconciliation of Unmatched Trades – Treasury Securities Options

All members, member firms, and clearing members shall resolve unmatched trades in Treasury securities options from the previous day's trading no later than 9:00 a.m. (Eastern Time) of the following business day.

Rule 1017D. Responsibilities of Floor Brokers – Treasury Securities Options

A Floor Broker handling a contingency order for Treasury securities options that is dependent upon quotations or prices other than those originating on the floor shall be responsible for satisfying the dependency requirement on the basis of the most reliable information reasonably available to him concerning such quotations and prices but, in no event, shall be held to an execution of such an order. Unless mutually agreed by the members involved, an execution or non-execution that results shall not be altered by the fact that such information is subsequently found to have been erroneous.

Rule 1018D. Limit Book for Treasury Securities Options

There shall be a limit order book for Treasury securities options.

Rule 1019D. Bid / Ask Differentials - Treasury Securities Options

(a) Without limiting the general obligation to deal for his account as stated in Rule 1014, a Specialist or Registered Options Trader holding an appointment in Treasury securities options, in the course of maintaining a fair and orderly market, is expected to bid and/or ask (offer) so as to create differences of:

(1) no more than $0.25 between the bid and offer for each option contract for which the bid is less than $1;

(2) no more than $0.50 where the bid is $1 or more but less than $5;

(3) no more than $0.80 where the bid is $5 or more but less than $10 ; and

(4) no more than $1 where the bid is $10 or more.

(b) The bid/ask differentials specified in this rule shall apply only to the two nearest term series of each class of Treasury securities options. For all longer term series the maximum bid/ask differentials are double those listed above.

Rule 1020D. Allocation of Exercise Assignment Notices – Treasury Securities Options

(a) In the case of Treasury securities options, the method of allocation of exercise notices established pursuant to Rule 1043 may provide that an exercise notice of block size shall be allocated to a customer or customers having an open short position of block size and that an exercise notice of less than block size shall not be allocated, to the extent feasible, to a customer having a short position of block size.

(b) A member organization shall allocate an exercise notice pertaining to a call option contract to a customer who has made a specific deposit of the underlying security if it is directed to do so by The Options Clearing Corporation (“OCC”).

(c) For the purposes of this Rule, an exercise notice or a short position in a series of options where the total principal amount is $1 million or more and where the underlying security is a Treasury security shall be deemed to be of "block size."

Rule 1021D. Delivery and Payment - Treasury Securities Options

Payment of the aggregate exercise price shall be accompanied by payment of accrued interest on the underlying Treasury security from but not including the last interest payment date to and including the exercise settlement date as specified in the Rules of the OCC.

Rule 1022D. Margin Requirements - Treasury Securities Options

Exchange member organizations shall comply with the initial and maintenance margin requirements of CBOE as the same may be in effect from time to time.

Rule 1023D. Furnishing of Books, Records and Other Information – Treasury Securities Options

(a) No specialists or Remote Options Traders in Treasury securities options shall fail to make available to the Exchange such books, records or other information maintained by or in the possession of such member or any corporate affiliate of such member pertaining to transactions by such member or any such affiliate for its own account in Treasury securities, Treasury securities futures or in Treasury securities options as may be called for under the Rules or as may be requested in the course of any investigation, any inspection or other official inquiry by the Exchange. In addition, the provisions governing identification of accounts and reports of orders shall, in the case of specialists or Registered Options Traders in Treasury securities options, apply to (i) accounts for Treasury securities deliverable under the terms of the option contracts involved, Treasury securities futures, options on Treasury securities futures and Treasury securities options trading; and (ii) orders entered by the specialist or Registered Options Trader for the purchase or sale of Treasury securities deliverable under the terms of the options contracts involved, Treasury securities futures, options on Treasury securities futures, options on Treasury securities and opening and closing positions therein.

(b) Any corporate affiliate of a Specialist or Registered Options Trader in Treasury securities options shall maintain and preserve such books, records or other information as may be necessary to comply with this rule.

Rule 1024D. Communication Links – Treasury Securities Options

The Exchange will permit members to establish and maintain communication links with other members for the purpose of obtaining timely information on price movements in Treasury securities on which options are dealt in on the Exchange. Written notice of each such communication link shall be promptly filed with the Exchange. The Exchange may condition or terminate the use of any such communication link if the Exchange deems such action to be necessary or appropriate in the interest of maintaining a fair and orderly market or for the protection of investors.

Rule 1025D. Doing Business With the Public – Treasury Securities Options

(a)Approval of the accounts of customers shall be conducted in accordance with Rule 747 and, in the case of institutional options customers (i.e., customers that are not natural persons), a member organization shall seek to obtain the following information:

(1) evidence of authority for the institution to engage in Treasury securities options transactions (corporate resolutions, trust documents, etc.);

(2) written designation of individuals within the institution authorized to act for it in connection with Treasury securities options transactions; and

(3) basic financial information concerning the institution.

(b) As a general matter, supervisory qualifications of a Registered Options Principal may be demonstrated only by successful completion of an examination prescribed by the Exchange (e.g. Series 4) for the purpose of demonstrating an adequate knowledge of Treasury securities options and the underlying Treasury securities. In exceptional circumstances and when good cause is shown, however, the Exchange may, upon written request by a member organization, accept as a demonstration of equivalent knowledge other evidence of a Registered Options Principal's supervisory qualifications. Advanced age, physical infirmity or experience in fields ancillary to the investment banking or securities business will not individually of themselves constitute sufficient grounds to excuse a Registered Options Principal from the general requirement that supervisory qualifications be shown by successful completion of an appropriate examination.

(c) The conduct of Treasury securities option business at a branch office of a member organization may be supervised by any Registered Options Principal of the member organization.

(d) Any sales personnel of a member organization who solicit or accept customer orders with regard to options on Treasury securities shall be deemed qualified with regard to such options after such personnel successfully completed an examination prescribed by the Exchange for the purpose of demonstrating adequate knowledge of options and the underlying Treasury securities.