

impact on OPRA's current quoting capacity.¹¹

Settlement of Index Options

The proposed Full-Size Index Options and Mini Index Options will expire on the Saturday following the third Friday of the expiration month.¹² Trading in the expiring contract month will normally cease at 4:15 P.M. ET on the immediately preceding Thursday. Nasdaq will calculate the exercise settlement value of the Index at option expiration based on the volume-weighted opening price ("Nasdaq VWOP") of the component securities in the first four minutes of trading (the "Extraction Period") on the business day prior to expiration, which will normally be a Friday. Each Index component will have a trade extraction history independently maintained beginning with the receipt of the first day's trade in that issue and continuing for four continuous minutes. Nasdaq will record and reflect trade adjustments during the Extraction Period for each component until the four-minute window for the last component stock closes or 10:30 A.M., whichever is sooner. Nasdaq will then calculate the Nasdaq VWOP for each security based on the extracted trades and aggregate the Nasdaq VWOPs of the Index's components to calculate the Index settlement value. If a stock fails to open for trading, the last available price on the stock will be used to calculate the Index, as is done for currently listed indexes. A stock will be deemed to have failed to open for trading when it does not open for trading prior to 10:30 A.M. on such trading day.

Surveillance

To monitor trading in Index Options, the Exchange will use the same surveillance procedures it uses currently for each of the Exchange's sector index options.¹³ These procedures include complete access to trading activity in the underlying securities. Movements in price and volume are used as a primary indicator

in detecting market manipulations such as insider trading activity within the underlying component issues of an index. The PHLX notes that underlying securities are used to determine trading rotations, halts or re-openings¹⁴ and to monitor for price and volume movements in the underlying component issues.

The Intermarket Surveillance Group ("ISG") Agreement, dated July 14, 1983, as amended, will be applicable to the trading of Index Options. According to the PHLX, as of July 31, 2003, 315 securities, representing 3.27% of the capitalization of the Index and 9.24% of the number of components in the Index, are incorporated outside the United States. Of those 315 securities, only 125, or 0.64% of the capitalization of the Index and 3.67% of the number of components in the Index, are incorporated in countries whose domestic equity exchange is not a member of ISG.¹⁵

Position Limits

The PHLX proposes to amend Phlx Rule 1001A to establish position limits of 50,000 contracts for Full-Size Index Options, with 30,000 contracts in the nearest expiration month, and 500,000 contracts for Mini Index Options on either side of the market, with 300,000 contracts total in the nearest expiration month. Exercise limits will be set at the same level as position limits. The proposed amendment to PHLX Rule 1001A will require that the position limits in Full-Size Index Options and Mini Index Options be aggregated for the purpose of determining compliance with position and exercise limits. The PHLX proposes to establish the position limit of the index hedge exemption at 150,000 contracts for Full-Size Index Options and 1,500,000 contracts for Mini Index Options. The Exchange proposes to amend PHLX Rule 1079 to establish a separate position limit of 50,000 contracts on the same side of the market for FLEX Index Options, with 30,000 contracts on the same side of the market in the nearest expiration month. For Mini FLEX Index Options, the PHLX proposes to establish a position limit of 500,000 contracts on the same

side of the market, with 300,000 contracts on the same side of the market in the nearest expiration month.

(2) Basis

The PHLX believes that the proposed rule change is consistent with Section 6(b)¹⁶ of the Act, in general, and furthers the objectives of Section 6(b)(5) of the Act,¹⁷ in particular, in that it is designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and practices, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to and facilitating transactions in securities, to remove impediments to and perfect the mechanism for a free and open market and a national market system, and to protect investors and the public interest.

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

The PHLX does not believe that the proposed rule change will impose any inappropriate burden on competition.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments were either solicited or received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

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

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

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

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies

¹¹ See Letter from Joseph P. Corrigan, Executive Director, OPRA, to Matthew Holm, Director, PHLX, dated September 16, 2003.

¹² Under PHLX Rule 1079(a)(6), a FLEX option on the Index may not expire on any day that falls on or within two business days prior to or subsequent to an expiration day for a non-FLEX option on the Index.

¹³ See, e.g., PHLX rules pertaining to: (1) affirmative quoting obligations (PHLX Rule 1014, "Obligations and Restrictions Applicable to Specialists and Registered Options Traders"); (2) priority and parity (PHLX Rule 1014); (3) execution guarantees (PHLX Rule 1015, "Execution Guarantees"); (4) firm quotations (PHLX Rule 1082, "Firm Quotations"); and (5) excessive dealing (PHLX Rule 1021, "Excessive Dealing in Options").

¹⁴ See PHLX Rule 1047A, "Trading Rotations, Halts or Reopenings."

¹⁵ See Securities Exchange Act Release No. 34157 (June 3, 1994), 59 FR 30062 (June 10, 1994) (order approving File Nos. SR-Amex-92-35; SR-CBOE-93-59; SR-NYSE-94-17; SR-PSE-94-07; and SR-PHLX-94-10) (establishing streamlined procedures for the listing of options on any narrow-based index that meets specified criteria, including, among other criteria, the requirement that non-U.S. component securities that are not subject to comprehensive surveillance agreements account for no more than 20% of the weight of the index).

¹⁶ 15 U.S.C. 78f(b).

¹⁷ 15 U.S.C. 78f(b)(5).