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**Neva R. Watson,**

*Attorney, Legislative.*

[FR Doc. E9-28767 Filed 12-1-09; 8:45 am]

**BILLING CODE 7710-12-P**

## **SMALL BUSINESS ADMINISTRATION**

**[Disaster Declaration #11939 and #11940]**

### **Virginia Disaster #VA-00026**

**AGENCY:** U.S. Small Business Administration.

**ACTION:** Notice.

**SUMMARY:** This is a notice of an Administrative declaration of a disaster for the Commonwealth of Virginia, dated 11/25/2009.

*Incident:* Severe Nor'easter coupled with the remnants of Hurricane Ida.

*Incident Period:* 11/12/2009 through 11/15/2009.

*Effective Date:* 11/25/2009.

*Physical Loan Application Deadline Date:* 01/25/2010.

*Economic Injury (EIDL) Loan Application Deadline Date:* 08/25/2010

**ADDRESSES:** Submit completed loan applications to: U.S. Small Business Administration, Processing and Disbursement Center, 14925 Kingsport Road, Fort Worth, TX 76155.

**FOR FURTHER INFORMATION CONTACT:** A. Escobar, Office of Disaster Assistance, U.S. Small Business Administration, 409 3rd Street, SW., Suite 6050, Washington, DC 20416.

**SUPPLEMENTARY INFORMATION:** Notice is hereby given that as a result of the Administrator's disaster declaration, applications for disaster loans may be filed at the address listed above or other locally announced locations.

The following areas have been determined to be adversely affected by the disaster:

*Primary Cities:* Hampton City, Newport News City, Norfolk City, Virginia Beach City.

*Contiguous Cities and Counties:*

Virginia: Chesapeake City, James City, Poquoson City, Portsmouth City, York.

North Carolina: Currituck.

The Interest Rates are:

	Percent
For Physical Damage:	
Homeowners With Credit Available Elsewhere .....	5.125
Homeowners Without Credit Available Elsewhere .....	2.562
Businesses With Credit Available Elsewhere .....	6.000

	Percent
Businesses Without Credit Available Elsewhere .....	4.000
Non-Profit Organizations With Credit Available Elsewhere .....	3.625
Non-Profit Organizations Without Credit Available Elsewhere .....	3.000
For Economic Injury:	
Businesses and Small Agricultural Cooperatives Without Credit Available Elsewhere .....	4.000
Non-Profit Organizations Without Credit Available Elsewhere .....	3.000

The number assigned to this disaster for physical damage is 119396 and for economic injury is 119400.

The States which received an EIDL Declaration # are Virginia, North Carolina.

(Catalog of Federal Domestic Assistance Numbers 59002 and 59008)

Dated: November 25, 2009.

**Karen G. Mills,**

*Administrator.*

[FR Doc. E9-28768 Filed 12-1-09; 8:45 am]

**BILLING CODE 8025-01-P**

## **SECURITIES AND EXCHANGE COMMISSION**

**Release No. 34-61066; File No. SR-Phlx-2009-98]**

### **Self-Regulatory Organizations; NASDAQ OMX PHLX, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Allow Tied Hedge Transactions**

November 25, 2009.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that, on November 20, 2009, NASDAQ OMX PHLX, Inc. ("Phlx" or the "Exchange") filed with the Securities and Exchange Commission (the "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 Commission a proposal to adopt Commentary .04 to Phlx Rule 1064

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

(Crossing, Facilitation and Solicited Orders) to allow hedging stock, security future or futures contract positions to be represented concurrently with option facilitations or solicitations in the trading crowd ("tied hedge" orders). The Exchange proposes to adopt a similarly worded Commentary .02 to Options Floor Procedure Advice ("OFPA" or "Advice") B-11 (Crossing, Facilitation and Solicited Orders) to harmonize it with Rule 1064. The Exchange also proposes to amend Rule 1066 (Certain Types of Orders Defined) and Commentary .08 to Rule 1080 (Phlx XL and XL II) to clarify definitional language in respect of tied hedge orders.

The text of the proposed rule change is available on the Exchange's Web site at <http://nasdaqomxphlx.cchwallstreet.com/NASDAQOMXPHLX/Filings/>, 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 self-regulatory organization 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 those 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 parts of such statements.

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

###### **1. Purpose**

The purpose of the proposal is to adopt new Commentary .04 to Phlx Rule 1064 and new Commentary .02 to OFPA B-11 to allow hedging stock, security future or futures contract positions to be represented currently with option facilitations or solicitations in the trading crowd (tied hedge orders); and to clarify definitional language in respect of tied hedge orders in Rules 1066 and 1080.

This rule change is based on a similar recently approved rule change proposal by another option exchange regarding tied hedge orders.<sup>3</sup>

<sup>3</sup> See Securities Exchange Act Release No. 60499 (August 13, 2009), 74 FR 42350 (August 21, 2009) (SR-CBOE-2009-007) (notice of filing and order granting accelerated approval regarding "tied hedge" transactions). SR-CBOE-2009-007 was, in

## Background

By way of background, Rule 1064 and OFPA B-11<sup>4</sup> generally deal with, among other things: (a) When an Options Floor Broker ("Floor Broker") who holds orders to buy and sell the same options series may cross such orders;<sup>5</sup> (b) when a Floor Broker holding an options order for a public customer and a contra-side order may cross such orders;<sup>6</sup> and (c) when a solicitation occurs where an order, other than a cross, is presented by a Floor Broker for execution in the trading crowd.<sup>7</sup> Rule 1064 also deals with firm participation guarantees entitling a Floor Broker to cross certain percentages of the original order with other orders that the Floor Broker is holding, or in the case of a public customer order, with facilitation orders of the original firm (i.e. the firm from which the original customer order originated).<sup>8</sup>

Additionally, Rule 1064 and OFPA B-11 indicate that a non member organization or person associated with a member or member organization who has knowledge of all the material terms of an order being facilitated, or an order being crossed, the execution of which is imminent, shall not enter (based on such knowledge) an order to: (a) Buy or sell an option for the same underlying security, (b) buy or sell a security underlying such class, or (c) buy or sell a related instrument (known as the "anticipatory hedge rule").<sup>9</sup>

The Exchange notes that Rule 1064 and OFPA B-11 were designed to preserve the right to solicit orders in advance of submitting a proposal to the

trading crowd, while at the same time assuring that orders that are the subject of solicitation are exposed to the auction market (trading crowd) in a meaningful way by prohibiting behavior such as anticipatory hedging.

Rule 1064 and OFPA B-11 provide that a violation of the rule or Advice, respectively, may be considered inconsistent with just and equitable principles of trade.<sup>10</sup>

When Phlx originally adopted the anticipatory hedge rule in 2001, the Exchange believed that the prohibition on anticipatory hedging was necessary to prevent members and associated persons from using undisclosed non-public information about imminent solicited option transactions to trade the relevant option or any closely-related instrument in advance of persons represented in the relevant options crowd.<sup>11</sup> While the Exchange has continued to believe that this basic principle remains true, changes in the marketplace have caused the Exchange to re-evaluate the effectiveness and efficiency of the Exchange's anticipatory hedge rule requirements.

The Exchange believes that increased volatility in the markets, as well as the advent of penny trading in underlying stocks and resultant decreased liquidity at the top of each underlying market's displayed NBBO, it has become increasingly difficult for members and member organizations to assess ultimate execution prices and the extent of available stock to hedge related options facilitation/solicitation activities, and to manage that market risk. This risk extends to simple and complex orders,<sup>12</sup> and to all market participants involved in the transaction (whether upstairs or on-floor) because of the uncertainty of the extent to which the market participant will participate in the transaction, the amount of time associated with the auction process, and the likelihood that the underlying stock prices in today's environment may be difficult to assess and may change before they are able to hedge. These circumstances can make it difficult to obtain a hedge, difficult to quote orders,

and difficult to achieve executions; and can translate into less liquidity in the form of smaller size and wider quote spreads, fewer opportunities for price improvement, and the inefficient handling of orders.

Additionally, more and more trading activity appears to be taking place away from the exchange-listed environment and in the over-the-counter ("OTC") market, which by its nature is not subject to the same trade-through type risks present in the exchange environment. Therefore, the Exchange is seeking to make its trading rules more efficient not only to address the market risk and execution concerns, but also to effectively compete with and attract volume from the OTC market. What is more, trading strategies of market-makers, which include Registered Options Traders ("ROTs") and specialists on the Exchange, have evolved.<sup>13</sup> Whereas market-makers previously tended to trade based on delta risk,<sup>14</sup> now market-making strategy tends to be based more on volatility.<sup>15</sup> The tied hedge transaction procedures (described below) are designed in a way that is consistent with this shift toward a volatility trading strategy, and makes it more desirable for market-makers to compete for orders that are exposed through the solicitation process.

## Proposed Exception to Anticipatory Hedge Rule

In order to address the concerns associated with increased volatility and decreased liquidity and more effectively compete with the OTC market, the

turn, based on a previous Phlx rule change proposal, SR-PHLX-2003-75, that was ultimately not pursued to approval. See Securities Exchange Act Release No. 48875 (December 4, 2003), 68 FR 70072 (December 16, 2003) (SR-PHLX-2003-75) (notice of filing).

<sup>4</sup> OFPA B-11 is similar in structure and content to Rule 1064 (with the exception that Commentaries .02 and .03 to Rule 1064 are not in OFPA B-11). A sentence regarding priority is added to subsection (c)(iii) of Rule 1064 for conformity with OFPA B-11.

<sup>5</sup> Rule 1064(a).

<sup>6</sup> Rule 1064(b).

<sup>7</sup> Rule 1064(c).

<sup>8</sup> Commentary .02 to Rule 1064. For purposes of this commentary, an "original order" is when a Floor Broker holds an equity, index or U.S. dollar-settled foreign currency option order of the eligible order size or greater. Commentary .02 provides further that spread, straddle, combination or hedge orders, as defined in Exchange Rule 1066, on opposite sides of the market may be crossed, provided that the Floor Broker holding such orders proceeds in the manner described in Rule 1064.

<sup>9</sup> Rule 1064(d). For purposes of this subsection (d), an order to buy or sell a "related instrument" means, "in reference to an index option, an order to buy or sell securities comprising 10% or more of the component securities in the index or an order to buy or sell a futures contract on an economically equivalent index."

<sup>10</sup> Commentary .01 to Rule 1064 and OFPA B-11. The language of Commentary .01 to OFPA B-11 is clarified to indicate that a violation of the Advice may be considered conduct inconsistent with just and equitable principles of trade.

<sup>11</sup> See Securities Exchange Act Release No. 44740 (August 23, 2001), 66 FR 45721 (August 29, 2001) (SR-PHLX-2001-61) (notice of filing and immediate effectiveness regarding, among other things, anticipatory hedge rule in Rule 1064 and OFPA B-11).

<sup>12</sup> Subsection (a)(i)(F) to Commentary .08 is clarified to indicate that Complex Orders include "tied hedge" orders. Rule 1066 is similarly clarified to indicate that hedge orders include "tied hedge" orders.

<sup>13</sup> For obligations and restrictions generally applicable to ROTs and specialists, see Rule 1014.

<sup>14</sup> The price of an option is not completely dependent on supply and demand, nor on the price of the underlying security. Market-makers price options based on fundamental measures of risk as well. One of these measures, delta, is the rate of change in the price of an option as it relates to changes in the price of the underlying security, security future or futures contract. The delta of an option is measured incrementally based on movement in the price of the underlying security, security future or futures contract. For example, if the price of an option increases or decreases by \$1.00 for each \$1.00 increase or decrease in the price of the underlying security, the option would have a delta of 100. If the price of an option increases or decreases by \$0.50 for each \$1.00 increase or decrease in the price of the underlying security, the option would have a delta of 50.

<sup>15</sup> Volatility is a measure of the fluctuation in the underlying security's market price. Market-makers that trade based on volatility generally have options positions that they hedge with the underlying. Once hedged, the risk exposure to the market-maker is realized volatility and implied volatility. Realized volatility (also known as historical volatility) is the actual volatility in the underlying. Implied volatility is determined by using option prices existing in the market at the time rather than using historical data on the market price changes of the underlying.

Exchange is proposing to adopt in Commentary .04 to Rule 1064 and Commentary .02 to OFPA B-11 a limited exception to the anticipatory hedging restrictions that would permit the representation of hedging stock positions in conjunction with option orders in the options trading crowd (a “tied hedge” transaction). The Exchange believes this limited exception remains in keeping with the original design of Rule 1064(d), but sets forth a more practicable approach considering today’s trading environment that will provide the ability to hedge in a way that will still encourage meaningful competition among upstairs and floor traders. Besides stock positions, the proposal would also permit security futures positions to be used as a hedge. In addition, in the case where the order is for options on indices, options on exchange-traded funds (“ETFs”) or options on Holding Company Depository Receipts (“HOLDERS”), a related instrument may be used as a hedge. A “related instrument” would mean, in reference to an index option, securities comprising ten percent or more of the component securities in the index or a futures contract on any economically equivalent index applicable to the option order. A “related instrument” would mean, in reference to an ETF or HOLDER option, a futures contract on any economically equivalent index applicable to the ETF or HOLDER underlying the option order.<sup>16</sup>

With a tied hedge transaction, Exchange members would be permitted to hedge an option order with the underlying security, a security future or futures contract, as applicable, and then forward the option order and the hedging position to an Exchange Floor Broker with instructions to represent the option order together with the hedging position to the options trading crowd. The in-crowd market participants that chose to participate in the option transaction must also participate in the hedging position.

First, under the proposal, the original option order must be in a class designated as eligible for a tied hedge transaction as determined by the Exchange, including FLEX options classes.<sup>17</sup> The original option order

must also be within designated tied hedge eligibility size parameters, which would be determined by the Exchange and would not be smaller than 500 contracts.<sup>18</sup> The Exchange notes that the minimum order size would apply to an individual original order.<sup>19</sup> Multiple original orders could not be aggregated to satisfy the requirement (though multiple contra-side solicited orders could be aggregated to execute against the original order). The Exchange states that the primary purpose of this provision is to limit use of the tied hedge procedures to larger orders that might benefit from a member’s or member organization’s ability to execute a facilitating hedge.<sup>20</sup> Assuming an option order meets these eligibility parameters, the proposal also includes a number of other conditions that must be satisfied.

Second, the proposal would also require that, prior to entering tied hedge orders on behalf of customers, the member or member organization must deliver to the customer a onetime written notification informing the customer that his order may be executed using the Exchange’s tied hedge procedures. Under the proposal, the written notification must disclose the terms and conditions contained in the proposed rule and be in a form approved by the Exchange. Given the minimum size requirement of 500 contracts per order, the Exchange believes that use of the tied hedges procedures will generally consist of orders for the accounts of institutional or sophisticated, high net worth investors. The Exchange therefore believes that a one-time notification delivered by the member or member organization to the customer would be sufficient, and that an order-by-order

notification would be unnecessary and overly burdensome.

Third, a member or member organization would be required to create an electronic record that it is engaging in a tied hedge order in a form and manner prescribed by the Exchange. The Exchange states that the purpose of this provision is to create a record to ensure that hedging trades would be appropriately associated with the related options order and appropriately evaluated in the Exchange’s surveillance program. The Exchange believes that this requirement should enable the Exchange to monitor for compliance with the requirements of the proposed rule, as discussed below, by identifying the specific purchase or sell orders relating to the hedging position.

Fourth, the proposed rule would require that members and member organizations that have decided to engage in tied hedge orders for representation in the trading crowd would have to ensure that the hedging position associated with the tied hedge order is comprised of a position that is designated as eligible for a tied hedge transaction. Eligible hedging positions would be determined by the Exchange for each eligible class and may include (a) The same underlying stock applicable to the option order, (b) a security future overlying the same stock applicable to the option order, or (c) in reference to an option on an index, ETF or HOLDER, a “related instrument” (as described above). For example, for options overlying XYZ stock, the Exchange may determine to designate the underlying XYZ stock or XYZ security futures or both as eligible hedging positions.<sup>21</sup> The Exchange states that the purpose of this provision is to ensure that the hedging position would be for the same stock, equivalent security future or related instrument, as applicable, thus allowing crowd participants who may be considering participation in a tied hedge order to adequately evaluate the risk associated with the option as it relates to the hedge. With stock positions in particular, the Exchange notes that occasionally crowd participants hedge option positions with stock that is related to the option, such as the stock of an issuer in the same industry, but not the actual stock associated with the option. Except as otherwise discussed above for index options, the proposed

<sup>18</sup> The designated classes and minimum order size applicable to each class would be communicated to the membership via an Options Regulatory Alert (“ORA”). For example, the Exchange could determine to make the tied hedge transaction procedures available in options class XYZ for orders of 1000 contracts or more. Such a determination would be announced via ORA, which would include a cumulative list of all classes and corresponding sizes for which the tied hedge procedures are available.

<sup>19</sup> In determining whether an individual original order satisfies the eligible order size requirement, any complex order must contain one leg alone which is for the eligible order size or greater. For complex order procedures generally, see Commentary .08 to Rule 1080 and Rule 1089(b)(2). For complex order procedures in respect of locked and crossed markets, see Rule 1083(d).

<sup>20</sup> The Exchange believes that, given the decreased amount of liquidity available at the NBBO, the frequency with which quotes may flicker, and differing costs associated with accessing liquidity on various markets, as well as for ease of administration, the proposed 500 contract minimum should be sufficient to address these considerations.

<sup>21</sup> As with designated classes and minimum order size, the eligible hedging positions applicable to each class would be communicated to the membership via ORA, which would include a cumulative list of all classes and corresponding sizes for which the tied hedge procedures are available. See note 19, *supra*.

<sup>16</sup> For example, a tied hedge order involving options on the iShares Russell 2000 Index ETF (IWM) might involve a hedge position in the underlying ETF, security futures overlying the ETF, or futures contracts overlying the Russell 2000 Index.

<sup>17</sup> FLEX options provide investors with the ability to customize basic option features including size, expiration date, exercise style, and certain exercise prices. See Rule 1079.

rule change would not allow such a "related" hedging stock position, but would require the hedging stock position to be the actual security underlying the option.

Fifth, the proposal would require that the entire hedging position be brought without undue delay to the trading crowd. In considering whether the hedging position is presented without "undue delay," the Exchange believes that members and member organizations should continue to have the same ability to shop an order in advance of presenting it to the crowd and should be able to enhance that process through obtaining a hedge. The Exchange also believes that, once a hedge is obtained, the order should be brought to the crowd promptly in order to satisfy the "undue delay" requirement. In addition, the proposal would require that the hedging position be announced to the trading crowd concurrently with the option order, offered to the crowd in its entirety, and offered at the execution price received by the member or member organization introducing the order to any in-crowd market participant who has established parity or priority for the related options. In-crowd market participants that participate in the option transaction must also participate in the hedging position on a proportionate basis<sup>22</sup> and would not be permitted to prevent the option transaction from occurring by giving a competing bid or offer for one component of the tied hedge order. The Exchange states that the purpose of these requirements is to ensure that the hedging position represented to the crowd would be a good faith effort to provide in-crowd market participants with the same opportunity as the member or member organization introducing the tied hedge order to compete most effectively for the option order.

For example, if a member or member organization introducing a tied stock hedge order were to offer 1,000 XYZ option contracts to the crowd (overlying 100,000 shares of XYZ stock) and concurrently offer only 30,000 of 100,000 shares of the underlying stock that the member obtained as a hedge, crowd participants might only be willing or able to participate in 300 of the option contracts offered if the hedging stock position cannot be obtained at a price as favorable as the stock hedging position offering price, if

at all. The Exchange states that the effect of this would be to place the crowd at a disadvantage relative to the introducing member or member organization for the remaining 700 option contracts in the tied stock hedge order, and thus create a disincentive for the crowd to bid or offer competitively for the remaining 700 option contracts. The Exchange believes the requirement that the hedging position be presented concurrently with the option order in the crowd and offered to the crowd in its entirety at the execution price received by the member or member organization introducing the order should ensure that the crowd would be competing on a level playing field with the introducing member or member organization to provide the best price to the customer.

Sixth, the proposal would require that the hedging position not exceed the options order on a delta basis. For example, in the situation where a tied stock hedge order involves the simultaneous purchase of 50,000 shares of XYZ stock and the sale of 500 XYZ call contract (known as a "buy-write"), and the delta of the option is 100, it would be considered "hedged" by 50,000 shares of stock. Accordingly, the proposed rule would not allow the introducing member firm to purchase more than 50,000 shares of stock in the hedging stock position. The Exchange believes that it is reasonable to require that the hedging position be in amounts that do not exceed the equivalent size of the related options order on a delta basis, and not for a greater number of shares. The Exchange believes that the proposed rule change would support its view that the member or member organization introducing the tied hedge order be guided by the notion that any excess hedging activity could be detrimental to the eventual execution price of the option order. Consequently, while delta estimates may vary slightly, the introducing member or member organization would be required to assume hedging positions not to exceed the equivalent size of the options order on a delta basis.<sup>23</sup>

<sup>23</sup> The Exchange notes that there may be scenarios where the introducing member purchases (sells) less than the delta, e.g., when there is not enough stock available to buy (sell) at the desired price. In such scenarios, the introducing member would present the stock that was purchased (sold) and share it with the in-crowd market participants on equal terms. This risk of obtaining less than a delta hedge is a risk that exists under the current rules because of the uncertainty that exists when market participants price an option and have to anticipate the price at which they will be able to obtain a hedge. The proposed tied hedge procedures are designed to help reduce this risk, but the initiating member may still be unable to execute enough stock at the desired price. To the extent the initiating

The Exchange believes that the delta basis requirement, together with the additional conditions that an introducing member or member organization bring the hedging position without undue delay to the trading crowd and announce it concurrently with the option order, offer it to the crowd in its entirety, and offer it at the execution price received by the member or member organization to any in-crowd market participant who has established parity or priority, will help assure that the hedging activity is bona fide and not for speculative or manipulative purposes. Additionally, the Exchange believes these conditions will help assure that there is no adverse affect on the auction market because, as discussed above, in-crowd market participants will have the same opportunity as the member or member organization introducing the tied hedge order to compete for the option order and will share the same benefits of limiting the market risk associated with hedging. The Exchange believes that customers will also benefit if the market risks are limited in the manner proposed. Once an original order is hedged, there is no delta risk. With the delta risk minimized, quotes will likely narrow as market participants (whether upstairs or on-floor) are better able to hedge and compete for orders. For example, market-makers could more easily quote markets to trade against a customer's original order based on volatility with the delta risk minimized, which should ultimately present more price improvement opportunities to the original order.<sup>24</sup>

At this time, the Exchange is not proposing any special priority provisions applicable to tied hedge transactions, though it intends to evaluate whether such changes are desired and may submit a separate rule filing on this subject in the future. Under the instant proposal, all tied hedge transactions will be treated as

member is able to execute any portion of the hedge, the risk exposure to the initiating member and in-crowd market participants would be diminished because those shares would be "tied up" and available for everyone that participates on the resulting tied hedge transaction. The Exchange does not believe that the initiating member would have an unfair advantage by having the ability to pre-facilitate less than a delta hedge because the proposed procedures would require the in-crowd market participants to get a proportional share of the hedge. To the extent more stock is needed to complete a hedge, the initiating member and the in-crowd market participants would have the same risk exposure that they do today.

<sup>24</sup> The Exchange also believes that the proposed exception to the anticipatory hedging procedures will assist in the Exchange's competitive efforts to attract order flow from the OTC market, which may result in increased volume on the exchange markets.

<sup>22</sup> For example, if an in-crowd market participant's allocation is 100 contracts out of a 500 contract option order (1/5), the same in-crowd market participant would trade 10,000 shares of a 50,000 stock hedge position tied to that option order (1/5).

complex orders. Priority will be afforded in accordance with the Exchange's existing open outcry allocation and reporting procedures for complex orders.<sup>25</sup> Any resulting tied hedge transactions will also be subject to the existing NBBO trade-through requirements for options and stock, as applicable. In this regard, the Exchange believes that the resulting option and stock components of the tied hedge transactions may qualify for various NBBO trade through exceptions including, for example, the complex trade exception.<sup>26</sup> However, when the option order is a simple order the execution of the option leg of a tied hedge transaction does not qualify it for any NBBO trade-through exception for a Complex Trade. Recognizing that tied hedge transactions involve complex orders and trades, the Exchange is amending the definition of Complex Order to clarify that these include "tied hedge" transactions.<sup>27</sup>

The Exchange recognizes that, at the time a tied hedge transaction is executed in a trading crowd, market conditions in any of the non-Phlx market(s) may prevent the execution of the non-options leg(s) at the price(s) agreed upon. For example, the execution price may be outside the non-Phlx market's best bid or offer ("BBO"), such as where the stock leg is to be executed at a price of \$25.03 and the particular stock market's BBO is \$24.93–\$25.02; such an execution would normally not be permitted unless an

exception applies that permits the trade to be reported outside the BBO.<sup>28</sup> The Exchange clarified in proposed Commentary .04 to Rule 1064 and Commentary.02 to OFPA B–11 that in the event the conditions in the non-Phlx market continue to prevent the execution of the non-option leg(s) at the agreed price(s), the trade representing the options leg(s) of the tied hedge transaction may be cancelled at the request of any member that is a party to the tied hedge transaction.

The following examples illustrate these principles:

- **Simple Original Order:** Introducing member receives an original customer order to buy 500 XYZ call options, which has a delta of 100. The introducing member purchases 50,000 shares of XYZ stock on the NYSE for an average price of \$25.03 per share. Once the stock is executed on the NYSE, the introducing member, without undue delay, announces the 500 contract option order and 50,000 share tied stock hedge at \$25.03 per share to the appropriate Phlx trading crowd.

- **Complex Original Order:** Introducing member receives an original customer stock-option order to buy 500 XYZ call options and sell 50,000 shares of XYZ stock. The introducing member purchases 50,000 shares of XYZ stock on the NYSE for an average price of \$25.03 per share. Once the stock is executed on the NYSE, the introducing member, without undue delay, announces the 500 contract option order and 50,000 share tied stock hedge at \$25.03 per share to the appropriate trading crowd.

In either the scenario regarding simple orders or the scenario regarding complex orders (which includes "tied hedge" orders), the next steps are the same and generally are no different from the procedures currently used to execute a complex order on Phlx in open outcry.

The Exchange notes regarding the examples above that:

- The in-crowd market participants would have an opportunity to provide competing quotes for the tied hedge package (and not for the individual component legs of the package). For example, assume the best net price is \$24.53 (equal to \$0.50 for each option contract and \$25.03 for each corresponding share of hedging stock).
- The option order and hedging stock would be allocated among the in-crowd market participants that established

priority or parity at that price, including the initiating member, in accordance with the allocation algorithm applicable to the options class, with the options leg being executed and reported on Phlx and the stock leg being executed and reported on the stock market specified by the initiating member. For example, the introducing member might trade 40% pursuant to an open outcry crossing entitlement (200 options contracts and 20,000 shares of stock) and the remaining balance might be with three different market-makers that each participated on 20% of the order (100 options contracts and 10,000 shares of stock per market-maker).

- The resultant tied hedge transaction: (a) would qualify as a "complex trade" under the Options Intermarket Linkage and the execution of the 500 option contracts with the market participants would not be subject to the NBBO for the particular option series in the scenario where the original order is a complex order (not a simple order); and (b) would qualify as a "qualified contingent trade" under Regulation NMS and the execution of the 30,000 shares of stock (the original 50,000 shares less the initiating member's 20,000 portion) with the market participants would not be subject to the NBBO for the underlying XYZ stock.

- The execution of the options leg would have to satisfy Phlx's intra-market priority rules for complex orders (including that the execution price may not be outside the Phlx BBO ("PBBO")). Thus, if the PBBO for the series was \$0.40–\$0.55, the execution could take place at or inside that price range (e.g., at the quoted price of \$0.50) and could not take place outside that price range (e.g., not at \$0.56).

- Similarly, the execution of the stock at \$25.03 per share would have to satisfy the intra-market priority rules of the non-Phlx market(s) where the stock is to be executed (including that the execution price may not be outside that market's BBO) or, alternatively, qualify for an exception that permits the trade to be reported outside the non-Phlx market(s) BBO.

- If market conditions in the non-Phlx market(s) prevent the execution of the stock leg(s) at the price(s) agreed upon from occurring (e.g., the BBO remains at \$24.93–\$25.02), then the options leg(s) could be cancelled at the request of any member that is a party to that trade.

While the particular circumstances surrounding each transaction on the Exchange's trading floor are different, the Exchange does not believe, as a general proposition, that the tied hedge

<sup>25</sup> For reporting procedures, *see*, Rules 1053 (Filing of Trade Information), 1003 (Reporting of Options Positions), 1022 (Securities Accounts and Orders of Specialists and Registered Options Traders), and 1028 (Confirmations). For allocation procedures, *see*, Rules 1014 (Obligations and Restrictions Applicable to Specialists and Registered Options Traders) and 1080 (Phlx XL and XL II). Options trading rules are generally located in the 1000 series of rules known as the Options Rules (Rule 1000 et. seq.) and include Rules 1001 (Position Limits), 1002 (Exercise Limits), 1033 (Bid and Offers—Premium), 1034 (Minimum Increments), and 1035 (Acceptance of Bid or Offer).

<sup>26</sup> *See* Rule 1085(b)(6) (Order Protection). Rules 1083 (Intermarket Linkage) through 1087 (Limitation on Principal Order Access) implement the recently-approved joint Options Order Protection and Locked/Crossed Market Plan (the "Protection and Locked/Crossed Plan"). *See* Securities Exchange Act Release No. 60405 (July 30, 2009), 74 FR 39362 (August 6, 2009) (File No. 4–546) (approval order for the Protection and Locked/Crossed Plan). *See also* Securities Exchange Act Release No. 60550 (August 20, 2009), 74 FR 44430 (August 28, 2009) (SR-Phlx-2009-61) (approval order for Phlx rules implementing the Protection and Locked/Crossed Plan).

<sup>27</sup> *See* Commentary .08(a)(i)(F) to Rule 1080. The Exchange notes that a complex order for "tied hedge" purposes in Rule 1080 is distinct from a complex trade for linkage purposes in Rule 1083; and that intramarket priority on the Exchange for tied hedge purposes is distinct from intermarket priority for linkage purposes.

<sup>28</sup> The Exchange notes that the possibility of this scenario occurring exists with complex order executions today and tied hedge transactions would present nothing unique or novel in this regard.

procedures would be inherently harmful or detrimental to customers or have an adverse affect on the auction market. Rather, the Exchange believes the procedures will improve the opportunities for an order to be exposed to a competitive auction and represent an improvement over the current rules. The fact that the parties to such a trade end up fully hedged may contribute to the best execution of the orders,<sup>29</sup> and, in any event, participants continue to be governed by, among other things, their best execution responsibilities. The Exchange also believes that the proposed tied hedge procedures are fully consistent with the original design of Rule 1064(d) which, as discussed above, was to eliminate the unfairness that can be associated with a solicited transaction and encourage meaningful competition. The tied hedge procedures should enable in-crowd market participants to be on equal footing with solicited parties in a manner that minimizes all parties' market risk while continuing to assure that orders are exposed in a meaningful way.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>30</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>31</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest, by establishing rules governing tied hedge orders, which include specific requirements and procedures to be followed. Specifically, the Exchange believes the procedures will improve the opportunities for orders to be exposed to price improvement in a manner that will encourage a fair, competitive auction process and minimize all parties' market risk.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

<sup>29</sup> As market participants are better able to hedge risk associated with completing these transactions, the Exchange believes that quotes may narrow and result in increased price improvement opportunities.

<sup>30</sup> 15 U.S.C. 78f(b).

<sup>31</sup> 15 U.S.C. 78f(b)(5).

## 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

Because the foregoing rule does not (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, provided that the self-regulatory organization has given the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change or such shorter time as designated by the Commission,<sup>32</sup> the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>33</sup> and Rule 19b-4(f)(6) thereunder.<sup>34</sup>

At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-Phlx-2009-98 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.

<sup>32</sup> The Exchange has satisfied this requirement.

<sup>33</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>34</sup> 17 CFR 240.19b-4(f)(6).

All submissions should refer to File Number SR-Phlx-2009-98. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such 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-2009-98 and should be submitted on or before December 23, 2009.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>35</sup>

**Elizabeth M. Murphy,**

*Secretary.*

[FR Doc. E9-28740 Filed 12-1-09; 8:45 am]

BILLING CODE 8011-01-P

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-61060 File No. SR-FINRA-2009-072]

### Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change To Amend the Deficient Claims Rules of the Codes of Arbitration Procedure for Customer and Industry Disputes

November 24, 2009.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934

<sup>35</sup> 17 CFR 200.30-3(a)(12).