

MEMORANDUM

TO: Members and Member Organizations

FROM: John Dayton

DATE: May 31, 2007

RE: Adoption of Listing Standards for Index-Linked Securities on XLE

The Exchange has received approval from the Securities and Exchange Commission for a proposed rule change, SR-Phlx-2007-07, which adopts listing standards and trading halt rules for Index-Linked Securities (a type of structured equity product) that may be listed and/or traded on XLE, Phlx's equity trading system. Index-Linked Securities are designed for investors who desire to participate in a specific market segment or combination of market segments through index products. Each Index-Linked Security is intended to provide investors with exposure to an identifiable underlying market index. Index-Linked Securities may or may not make interest payments to the holder during their term. Despite the fact that Index-Linked Securities are linked to an underlying index, each will trade as a single, exchange-listed security.

Prior to the listing or trading of any Index-Linked Security the Exchange will prepare and distribute an Information Memorandum that describes the product, highlighting the particular structure and corresponding risks of an Index-Linked Security. In particular, the Memorandum will set forth the Exchange's suitability rule that sets forth certain requirements for member organizations recommending a transaction in Index-Linked Securities. In addition, the Information Memorandum will note that all of the Exchange's equity trading rules will be applicable to trading in Index-Linked Securities. The Memorandum will also reference the member requirements to deliver a prospectus to each investor purchasing newly issued Index-Linked Securities prior to or concurrently with the confirmation of a transaction. The rule text is attached.

Questions regarding the proposed rule change may be directed to John Dayton at (215) 496-5162. Questions regarding security listing may be directed to Walt Smith at (215) 496-5532 or Todd Borneman at (215) 496-1261. Questions regarding XLE functionality may be directed to the XLE Help Desk at (215) 496-5311 or 1-877-678-PHLX.

Underlining indicates additions; brackets indicate deletions

Rule 136.

Trading Halts in Certain Exchange Traded Funds

(a)-(b) No Change

(c) The Exchange will halt trading in all Derivative Securities Products if the circuit breaker parameters of Phlx Rule 133 have been reached. In exercising its discretion to halt or suspend trading in a Derivative Securities Product pursuant to Phlx Rule 164(a), the Exchange may consider factors such as the extent to which trading in the underlying securities is not occurring or whether other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present, in addition to other factors that may be relevant. In particular, when the Exchange is the listing market for a Derivative Securities Product, if the Required Value applicable to that Derivative Securities Product is not being calculated and disseminated as required, the Exchange may halt trading during the day in which the interruption to the dissemination of the Required Value occurs. If the interruption to the dissemination of the Required Value persists past the trading day in which it occurred the Exchange will halt trading no later than the beginning of the trading day following the interruption.

(d) Trading Halts for Trading of Certain Derivative Securities Products on XLE Pursuant to Unlisted Trading Privileges

(1) During Pre Market Session. If a Derivative Securities Product begins trading on XLE in the Pre Market Session and subsequently a temporary interruption occurs in the calculation or wide dissemination of an applicable Required Value, XLE may continue to trade the Derivative Securities Product for the remainder of the Pre Market Session.

(2) During Core Session. During the Core Session, if a temporary interruption occurs in the calculation or wide dissemination of an applicable Required Value, and the listing market halts trading in the Derivative Securities Product, Phlx, upon notification by the listing market of a halt due to such temporary interruption, also shall immediately halt trading in the Derivative Securities Product on XLE.

(3) Post Market Session and Next Trading Day.

(A) If an applicable Required Value continues not to be calculated or widely disseminated after the close of the Core Session, XLE may trade the Derivative Securities Product in the Post Market Session only if the listing market traded the Derivative Securities Product until the close of its regular trading session without a halt.

(B) If an applicable Required Value continues not to be calculated or widely disseminated as of the beginning of the Pre Market Session on the next trading day, XLE shall not commence trading of the Derivative Securities Product in the Pre Market Session that day. If an interruption in the calculation or wide dissemination of an applicable Required Value continues, XLE may resume trading in the Derivative Securities Product only if calculation and wide dissemination of the applicable Required Value resumes or trading in the Derivative Securities Product resumes in the listing market.

(e) For purposes of this Rule:

(1) “Derivative Securities Product” means a series of Index-Linked Securities (Phlx Rule 803(n)).

(2) “Required Value” shall mean (i) the value of any index underlying a Derivative Securities Product, and (ii) the Intraday Indicative Value (as defined in Rule 803).

Rule 803 Criteria for Listing – Tier I

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(a)-(m) No Change.

(n) Index-Linked Securities

Index-linked securities are securities that provide for the payment at maturity of a cash amount based on the performance of an underlying index or indexes. Such securities may or may not provide for the repayment of the original principal investment amount. The Exchange may submit a rule filing pursuant to Section 19(b)(2) of the Securities Exchange Act of 1934 to permit the listing and trading of index-linked securities that do not otherwise meet the standards set forth below in paragraphs (1) through (11). The Exchange will consider for listing and trading pursuant to Rule 19b-4(e) under the Securities Exchange Act of 1934, index-linked securities provided:

(1) Both the issue and the issuer of such security meet the criteria set forth above in (f). The minimum public distribution and minimum public shareholders requirement will not be applicable to an issue traded in thousand dollar denominations. In addition, the minimum public shareholders requirement will not apply if the securities are redeemable at the option of the holders thereof on at least a weekly basis.

(2) The issue has a minimum term of one (1) year but not greater than thirty (30) years.

(3) The issue must be the non-convertible debt of the issuer.

(4) The payment at maturity may or may not provide for a multiple of the positive performance of an underlying index or indexes; however, in no event will payment at maturity be based on a multiple of the negative performance of an underlying index or indexes.

(5) The issuer will be expected to have a minimum tangible net worth in excess of \$250,000,000, and to otherwise substantially exceed the earnings requirements set forth in Rule 803(a)(2). In the alternative, the issuer will be expected: (A) to have a minimum tangible net worth of \$150,000,000 and to otherwise substantially exceed the earnings requirement set forth in Rule 803(a)(2), and (B) not to have issued securities where the original issue price of all the issuer's other index-linked note offerings (combined with index-linked note offerings of the issuer's affiliates) listed on a national securities exchange or traded through the facilities of Nasdaq exceeds 25% of the issuer's net worth.

(6) The issuer is in compliance with Rule 10A-3 under the Securities Exchange Act of 1934.

(7) Initial Listing Criteria—Each underlying index is required to have at least ten (10) component securities. In addition, the index or indexes to which the security is linked shall either (1) have been reviewed and approved for the trading of options or other derivatives by the Commission under Section 19(b)(2) of the 1934 Act and rules thereunder and the conditions set forth in the Commission's approval order, including comprehensive surveillance sharing agreements for non-U.S. stocks, continue to be satisfied, or (2) the index or indexes meet the following criteria:

(A) Each component security has a minimum market value of at least \$75 million, except that for each of the lowest weighted component securities in the index that in the aggregate account for no more than 10% of the weight of the index, the market value can be at least \$50 million;

(B) Each component security shall have trading volume in each of the last six months of not less than 1,000,000 shares, except that for each of the lowest weighted component securities in the index that in the aggregate account for no more than 10% of the weight of the index, the trading volume shall be at least 500,000 shares in each of the last six months;

(C) In the case of a capitalization weighted index or modified capitalization weighted index, the lesser of the five highest weighted component securities in the index or the highest weighted component securities in the index that in the aggregate represent at least 30% of the total number of component securities in the index, each have an average

monthly trading volume of at least 2,000,000 shares over the previous six months;

(D) No underlying component security will represent more than 25% of the weight of the index, and the five highest weighted component securities in the index do not in the aggregate account for more than 50% of the weight of the index (60% for an index consisting of fewer than 25 component securities);

(E) 90% of the index's numerical value and at least 80% of the total number of component securities will meet the then current criteria for standardized option trading set forth in Rule 1009;

(F) All component securities shall be either (A) securities (other than foreign country securities and American Depositary Receipts ("ADRs")) that are (i) issued by a Securities Exchange Act of 1934 reporting company which is listed on a national securities exchange and an NMS Stock or (B) be foreign country securities or ADRs, provided that foreign country securities or foreign country securities underlying ADRs having their primary trading market outside the United States on foreign trading markets that are not members of the Intermarket Surveillance Group or parties to comprehensive surveillance sharing agreements with the Exchange will not in the aggregate represent more than 20% of the dollar weight of the index.

(8) Continued Listing Criteria—(A) The Exchange will commence delisting or removal proceedings, if any of the standards set forth above in paragraph (7) are not continuously maintained, except that:

(i) the criteria that no single component represent more than 25% of the weight of the index and the five highest weighted components in the index can not represent more than 50% (or 60% for indexes with less than 25 components) of the weight of the Index, need only be satisfied for capitalization weighted, modified capitalization weighted and price weighted indexes as of the first day of January and July in each year;

(ii) the total number of components in the index may not increase or decrease by more than 33-1/3% from the number of components in the index at the time of its initial listing, and in no event may be less than ten (10) components;

(iii) the trading volume of each component security in the index must be at least 500,000 shares for each of the last six months, except that for each of the lowest weighted components in the index that in the aggregate account for no more than 10% of the

weight of the index, trading volume must be at least 400,000 shares for each of the last six months; and

(iv) in a capitalization-weighted index or modified capitalization weighted index, the lesser of the five highest weighted component securities in the index or the highest weighted component securities in the index that in the aggregate represent at least 30% of the total number of stocks in the index have had an average monthly trading volume of at least 1,000,000 shares over the previous six months.

(B) In connection with an index-linked security that is listed pursuant to paragraph (7)(1) above, the Exchange will commence delisting or removal proceedings if an underlying index or indexes fails to satisfy the maintenance standards or conditions for such index or indexes as set forth by the Commission in its order under Section 19(b)(2) of the 1934 Act approving the index or indexes for the trading of options or other derivatives.

(C) The Exchange will also commence delisting or removal proceedings, under any of the following circumstances:

(i) if the aggregate market value or the principal amount of the securities publicly held is less than \$400,000;

(ii) if the value of the index or composite value of the indexes is no longer calculated or widely disseminated on at least a 15-second basis during the time the security is traded on the Exchange; or

(iii) if such other event shall occur or condition exists which in the opinion of the Exchange makes further dealings on the Exchange inadvisable.

(9) Index Methodology and Calculation—(A) There must be disseminated for each series of Index-linked security an estimate, updated at least every 15 seconds, of the value of a unit of each series (the “Intraday Indicative Value”). (B) Indexes based upon the equal-dollar or modified equal-dollar weighting method will be rebalanced at least quarterly. (C) If the index is maintained by a broker-dealer, the broker-dealer shall erect a “firewall” around the personnel who have access to information concerning changes and adjustments to the index and the index shall be calculated by a third party who is not a broker-dealer. (D) The current value of an index will be widely disseminated at least every 15 seconds by one or more major market data vendors or over the consolidated tape. (E) If the value of an index-linked security is based on more than one (1) index, then the composite value of such indexes must be widely disseminated at least

every 15 seconds. (F) Any advisory committee, supervisory board, or similar entity that advises an Index Licensor or Administrator or a major market data vendor or that makes decisions on the index or portfolio composition, methodology and related matters, must implement and maintain, or be subject to, procedures designed to prevent the use and dissemination of material non-public information regarding the applicable index. An Index Licensor or Administrator includes any person who licenses to the Exchange the right to use an index or portfolio that is the basis for determining the inclusion and relative representation of an index-linked securities' component stocks, or any trademark or service mark associated with such an index or portfolio; collects, calculates, compiles, reports and/or maintains such an index or portfolio, or index and index-linked securities information relating to such an index; provides facilities for the dissemination of index and index-linked securities information; and/or is responsible for any of the activities described above.

(10) Surveillance Procedures. The Exchange will implement written surveillance procedures for index-linked securities, including adequate comprehensive surveillance sharing agreements for non-U.S. securities, as applicable.

(11) Index-linked securities will be treated as equity instruments.