

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-52187; File No. SR-Phlx-2005-32)

August 1, 2005

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Participation Guarantees for Floor Brokers Representing Crossing and Facilitation Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 22, 2005, the Philadelphia Stock Exchange, Inc. (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Phlx. The Exchange filed the proposal pursuant to Section 19(b)(3)(A) of the Act,<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposal effective upon filing with the Commission. 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 Phlx proposes to amend Exchange Rule 1064 concerning the guaranteed participation to which a Floor Broker is entitled with respect to equity options when seeking to execute crossing and facilitation transactions. Under the current rule, after requesting a market from the trading crowd, a Floor Broker seeking to cross an order for equity options that he or she is holding with another order, or, in the case of a public customer order, with a facilitation order

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

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

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

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

from the firm from which the public customer order originated, is entitled to a guaranteed participation of 20% when the order trades at a price that matches the price given by the trading crowd in response to the initial request for a market, and 40% when the order trades at a price that improves upon that price. The proposed rule change would entitle the Floor Broker to a 40% guarantee in both cases. The proposed rule change would also clarify that the corresponding guaranteed participation to which a specialist is entitled would continue to be a percentage that, combined with the percentage that the Floor Broker crossed, is no more than 40% of the original order. The text of amended Exchange Rule 1064 is set forth below. Brackets indicate deletions; italics indicate new text.

#### Crossing, Facilitation and Solicited Orders

Rule 1064. (a) - (d) No change.

Commentary:

.01 No change.

.02 Firm Participation Guarantees.

(i) - (ii) No change.

(iii) The percentage of the order which a Floor Broker is entitled to cross, after all public customer orders that were (1) on the limit order book and then (2) represented in the trading crowd at the time the market was established have been satisfied, is determined as follows:

(A) With respect to orders for equity options, [ (i) 2] 40% of the remaining contracts in the order if the order is traded at or between the best bid or offer given by the crowd in response to the Floor Broker's initial request for a market [; or (ii) 40% of the remaining contracts in the order if the order is traded between the best bid or offer given by the crowd in response to the Floor Broker's initial request for a market].

(B) With respect to orders for index options, 20% of the remaining contracts in the order.

(iv) - (v) No change.

(vi) If a trade pursuant to this Commentary occurs when the specialist is on parity with one or more controlled accounts, then the Enhanced Specialist Participation which is established pursuant to Exchange Rule 1014(g)(ii)-(iv) shall apply only to the number of contracts remaining after the following orders have been satisfied: those public customer orders which trade ahead of the cross transaction, and any portion of an order being crossed against the original order being represented by the Floor Broker.

(A) Respecting orders for index options, [T] the Enhanced Specialist Participation may only be 20% of the original order after customer orders have been executed for orders crossed pursuant to this paragraph (vi) unless the Floor Broker has chosen to cross less than its 20% entitlement, in which case the Enhanced Specialist Participation will be a percentage that combined with the percentage the firm crossed is no more than 40% of the original order.

(B) Respecting orders for equity options, the specialist shall not be entitled to receive the Enhanced Specialist Participation after customer orders have been executed for orders crossed pursuant to this paragraph (vi) unless the Floor Broker has chosen to cross less than its 40% entitlement, in which case the Enhanced Specialist Participation will be a percentage that combined with the percentage the firm crossed is no more than 40% of the original order.

If the trade occurs at a price other than the specialist's disseminated bid or offer, the specialist is entitled to no guaranteed participation.

(vii) - (x) No change.

.03 No change.

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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 Phlx 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 Phlx 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 the proposed rule change is to enable the Exchange to remain competitive with other exchanges by revising the current participation guarantee applicable to Exchange Floor Brokers that engage in crossing and facilitation transactions in equity options traded on the Exchange. Currently, Exchange Rule 1064, Commentary .02(iii) provides that, respecting orders for equity options, a Floor Broker is entitled to a participation guarantee of 20% of the remaining contracts (after all public customer orders that were on the limit order book and represented in the trading crowd at the time the market was established have been satisfied) if the order is traded at the best bid or offer (“BBO”) given by the crowd in response to the Floor Broker’s initial request for a market, or 40% of the remaining contracts if the order is traded between the best bid or offer given by the crowd in response to the Floor Broker’s initial request for a market.

The proposal would provide that, respecting orders for equity options, the Floor Broker is entitled to cross, after all public customer orders that were on the limit order book and represented in the trading crowd at the time the market was established have been satisfied, 40% of the remaining contracts in the order if the order is traded at or between the best bid or offer given by the crowd in response to the Floor Broker’s initial request for a market.

Current Commentary .02(vi) to Rule 1064 entitles the specialist to an Enhanced Specialist Participation<sup>5</sup> with respect to orders for equity options of 20% of the original order size when the Floor Broker crosses 20% of the order at the trading crowd’s price. If the Floor Broker improves upon the crowd’s price and takes its 40% entitlement, the specialist is not entitled to an Enhanced

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<sup>5</sup> Exchange Rules 1014(g)(ii) – (iv) establish the Enhanced Specialist Participation.

Specialist Participation. The proposed amendments to Commentary .02(vi) to the rule would clarify that the specialist also may not be entitled to an Enhanced Specialist Participation if the Floor Broker crosses the order at the trading crowd's price, and that, respecting orders for both index and equity options, the Enhanced Specialist Participation when combined with the amount of the order the Floor Broker crosses may not exceed 40%.

Respecting index options, the Enhanced Specialist Participation would remain unchanged. The specialist would, in most instances, be entitled to receive an Enhanced Specialist Participation of 20%,<sup>6</sup> because the Floor Broker may only cross 20% of the order regardless of the price.<sup>7</sup> Respecting equity options, the effect of the proposed rule change would be that specialists are generally not entitled to the Enhanced Specialist Participation (because the Floor Broker typically would take its 40% guaranteed amount) unless the Floor Broker crosses less than 40% of the order. The proposed rule text would clearly indicate this limitation.

The Exchange believes that the proposed rule change will enable the Exchange to compete for order flow in crossing and facilitation orders with other options exchanges that currently have similar rules in place.<sup>8</sup>

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<sup>6</sup> See current Exchange Rule 1064, Commentary .02(vi) and proposed Exchange Rule 1064, Commentary .02(vi)(A).

<sup>7</sup> See Exchange Rule 1064, Commentary .02(iii)(B).

<sup>8</sup> See Chicago Board Options Exchange, Incorporated Rule 6.74(d), American Stock Exchange LLC Rule 950(d), Commentary .02, and Pacific Exchange, Inc. Rule 6.47(b).

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>9</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>10</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 providing Floor Brokers and Exchange crowd participants with rules setting forth guidelines regarding the percentage of crossing and facilitation orders in equity and index options to which Floor Brokers are entitled.

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

The Exchange 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

Because the proposed rule change 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 after the date of filing or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>11</sup> and Rule 19b-4(f)(6) thereunder.<sup>12</sup>

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<sup>9</sup> 15 U.S.C. 78f(b).

<sup>10</sup> 15 U.S.C. 78f(b)(5).

<sup>11</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>12</sup> 17 CFR 240.19b-4(f)(6).

A proposed rule change filed under 19b-4(f)(6) normally may not become operative prior to 30 days after the date of filing.<sup>13</sup> However, Rule 19b-4(f)(6)(iii)<sup>14</sup> permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange provided the Commission with written notice of its intent to file this proposed rule change at least five business days prior to the date of filing the proposed rule change. In addition, the Exchange has requested that the Commission waive the 30-day pre-operative delay. The Commission believes that waiving the 30-day pre-operative delay is consistent with the protection of investors and the public interest because it would allow the Exchange to remain competitive with other exchanges that currently have similar rules in effect. For the reasons stated above, the Commission designates the proposal to become operative immediately.<sup>15</sup>

At any time within 60 days of the filing of the 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 the 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:

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<sup>13</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>14</sup> Id.

<sup>15</sup> For purposes only of waiving the pre-operative delay for this proposal, the Commission has considered the impact of the proposed rule on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).



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-2005-32 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-Phlx-2005-32. 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. Copies of such filing also will be available for inspection and copying at the principal office of the Phlx. 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-2005-32 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

Jill M. Peterson  
Assistant Secretary

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<sup>16</sup> 17 CFR 200.30-3(a)(12).