

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52777; File No. SR-Phlx-2004-37)

November 16, 2005

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing of a Proposed Rule Change and Amendment No. 1 Thereto to Increase the Size of the Audit Committee

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on May 20, 2004, 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, II, and III below, which Items have been prepared by the Exchange. On October 20, 2005, the Exchange filed Amendment No. 1 to the proposed rule change.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend the Phlx By-Laws, Article X, Sections 10-9 (a) - (b) to: (i) allow the Board of Governors the ability to increase the size of the Audit Committee beyond its current three persons to a maximum of five persons, and (ii) to require the members of the Audit Committee to be independent directors. Additionally, the proposed amendment to the Phlx By-Laws incorporates enhanced Audit Committee responsibilities. The text of the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, the Exchange revised the proposed rule text to add a definition of “independent director” and to make certain technical changes, and also revised the purpose section to reflect these changes and to enhance the description of the proposal generally.

proposed rule change, as amended, is below. Proposed deletions are bracketed; proposed insertions are underlined.

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PHLX BY-LAWS

Article 10, Sec. 10-9, Audit Committee

SEC. 10-9.

(a) The Audit Committee shall consist of at least three (3) members, the exact number to be determined from time to time by the Board of Governors. [who] All members shall [all] be [public] [independent non-industry Governors who have no material business relationship with the Exchange. A majority of the members, but not less than three (3) members shall be public Governors] independent directors who have no material relationship with the Exchange. [Audit Committee members shall not serve in a management capacity with the Exchange or any affiliate thereof and must be free of any other relationships that, by decision of the Board of Governors, would interfere with the exercise of independent judgment.] The term “independent director” will be defined as a director who has no material relationship with the Exchange or any affiliate of the Exchange, any Member of the Exchange or any affiliate of such Member, or any issuer of securities that are listed or traded on the Exchange or a facility of the Exchange. The term “material relationship” will be defined as a relationship, whether compensatory or otherwise, that reasonably could affect the independent judgment or decision-making of the director.

(b) The Audit Committee shall have responsibility for dealings with the Exchange’s [independent public accountants including] external auditors, which includes: (i) [making

recommendations to the Board of Governors as to] sole responsibility for the appointment, retention and [dismissal of such public accountants] replacement of such auditors; (ii) direct oversight over such auditors; (iii) review, at least annually, of the qualification and performance of such auditors; [reviewing the scope of their services and fees; (iii) reviewing the audit plan;] (iv) direct authority to resolve disagreements between management and such auditors regarding financial reporting [reviewing internal controls]; (v) responsibility to ensure the rotation of the lead and concurrent auditors every five years and certain other auditors every seven years, with time out periods; (vi) evaluation of the independence of external auditors, including ensuring that, other than deferred tax and compliance services, external auditors do not engage in certain non-audit services, as identified in the Audit Committee Charter, when they conduct audits for the Exchange, and approval of non-audit services where appropriate; (vii) [reviewing] review of the “management letter” and reply thereto; and (viii) [having] the ability to meet with [the public accountants] external auditors without Exchange officers or employees.

The Audit Committee shall have responsibility for the Exchange’s Internal Audit Department, which shall report to the Audit Committee. Such responsibility will include review of policies and procedures for and significant reports produced by the Internal Audit Department.

The Audit Committee shall review any legal matters that may materially impact the Exchange’s financial statements and all examination, inspection or other reports made by any regulatory agency with regulatory oversight for the Exchange and the Exchange’s responses thereto.

The Audit Committee shall review, at least annually, compliance with the Exchange's Code of Conduct with the assistance of the General Counsel's office.

The Audit Committee shall have the authority to conduct special reviews of any alleged improper conduct with respect to Exchange related activity, operations, finance or regulation.

The Audit Committee shall establish procedures for the receipt, retention, and treatment of complaints received by the Exchange regarding accounting, internal accounting controls, or other auditing matters and confidential anonymous submissions by Exchange employees regarding questionable accounting practices.

The Audit Committee may select and engage its own [counsel, consultants, accountants or other experts] advisor(s) to assist [in such reviews] it in carrying out its duties.

The Audit Committee shall determine the appropriate amount of funding to be provided by the Exchange for the purpose of paying: (i) compensation to external auditors retained by the Audit Committee to prepare or issue an audit report; (ii) compensation to adviser(s) employed by the Audit Committee that it determines are necessary to carry out its duties; and (iii) ordinary administrative expenses of the Audit Committee that are necessary or appropriate to carry out its duties in respect of external auditors.

The Audit Committee shall have the authority to compel to appear and/or provide documents or other information, by members, member organizations, associated persons of member organizations, members of the Board of Governors, committee members, Exchange officers or Exchange employees.

(c) The Audit Committee shall meet at least once every calendar quarter.

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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 Exchange included statements concerning the purpose of, and basis for, the proposed rule change, as amended, and discussed any comments it received on the proposal. 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 the proposed rule change, as amended, is to strengthen the composition and charter of the Exchange's Audit Committee by increasing the pool of candidates eligible to serve, which may bring additional expertise to the Committee, as well as codifying more of the Audit Committee's responsibilities. The Exchange believes that expanding the size of its Audit Committee to permit (but not mandate) additional Committee members should be beneficial, because additional persons should bring new and different expertise and experience to Committee workings. The Exchange further believes that by setting higher standards with the independence requirement, it will promote independent decision-making by the Audit Committee. The term "independent director" would be defined as a director who has no material relationship with the Exchange or any affiliate of the Exchange, any member of the Exchange or any affiliate of such member, or any issuer of securities that are listed or traded on the Exchange

or a facility of the Exchange.⁴ The term “material relationship” would be defined as a relationship, whether compensatory or otherwise, that reasonably could affect the independent judgment or decision-making of the director.⁵

The proposal would require the Exchange’s Board of Governors’ to determine whether each Audit Committee member is independent upon that director’s nomination and thereafter no less frequently than annually and as often as necessary in light of the director’s circumstances.⁶ The proposal would also give the Exchange’s Board of Governors the opportunity from time to time to adjust the number of members of the Exchange’s Audit Committee.

The Exchange believes that the codification of the Committee’s responsibilities with greater specificity is also appropriate. The proposal incorporates into the Phlx By-Laws enhanced Audit Committee responsibilities that are primarily adopted from the Sarbanes-Oxley Act of 2002.⁷ The Exchange also proposes to remove the phrase “independent public accountants” from Section 10-9(b) of Article X of the Phlx By-Laws and replace it with the phrase “external auditors” to broaden the scope of the audit committee’s oversight.

⁴ In submitting this proposal, the Exchange has cited to the Commission’s proposed rules for “independent directors” of self-regulatory organizations and certain other aspects of the Commission’s self-regulatory organization governance proposal. See Securities Exchange Act Release No. 50699 (November 18, 2004), 69 FR 71126 (December 8, 2004) (proposing Commission rules relating to the governance of self-regulatory organizations, among other things) (“SRO Governance Proposal”), Proposed Rules 6a-5(c)(2) and 15Aa-3(c)(2).

⁵ See SRO Governance Proposal, Proposed Rules 6a-5(b)(13) and 15Aa-3(b)(14) (proposed definition of “material relationship”).

⁶ See SRO Governance Proposal, Proposed Rules 6a-5(c)(2) and 15Aa-3(c)(2) (proposed schedule of independence determinations by Board).

⁷ While the Sarbanes-Oxley Act of 2002 does not by its terms apply to the Exchange, the Exchange has embraced applicable concepts on a voluntary compliance basis.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act⁸ in general, and furthers the objectives of Section 6(b)(5) of the Act⁹ in particular, in that it is designed to protect investors and the public interest.

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

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

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

⁸ 15 U.S.C. 78f(b).

⁹ 15 U.S.C. 78f(b)(5).

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. 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-2004-37 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-Phlx-2004-37. 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 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-2004-37 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.¹⁰

Jonathan G. Katz
Secretary

¹⁰ 17 CFR 200.30-3(a)(12).