

**SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52241; File No. SR-PCX-2005-31)**

August 11, 2005

Self-Regulatory Organizations; Pacific Exchange, Inc.; Order Approving a Proposed Rule Change and Amendments No. 1, 2, and 3 Thereto to Permit Lead Market Makers to Operate Remotely

I. Introduction

On March 15, 2005, the Pacific Exchange, Inc. (“PCX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend its rules to allow Lead Market Makers (“LMMs”) to operate from a remote location. The Exchange submitted Amendments No. 1, 2, and 3 on May 27, 2005,³ June 6, 2005,⁴ and June 22, 2005,⁵ respectively. On July 6, 2005, the proposal, as amended, was published for comment in the Federal Register.⁶ No comment letters were received on the proposal. The Commission is approving the proposed rule change, as amended.

II. Description of the Proposal

The proposed rule change amends the Exchange’s trading rules in order to allow

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 makes clarifying changes to the purpose statement and rule text. Amendment No. 1 replaces the original rule filing in its entirety.

⁴ Amendment No. 2 makes a technical correction to the rule text in Exhibit 5.

⁵ Amendment No. 3 clarifies how a Lead Market Maker will garner their guaranteed trade allocations by adding the words “via the PCX Plus system” at the end of the second paragraph in the purpose statement. Amendment No. 3 also eliminates the deletion of PCX Rule 6.37(f)(1).

⁶ See Securities Exchange Act Release No. 51937 (June 29, 2005), 70 FR 38997.

OTP Holders and OTP Firms who conduct Lead Market Making activity to do so whether on the trading floor or from a remote location. Currently, the PCX rules require a Lead Market Maker be physically present on the trading floor in order to conduct Lead Market Maker activities. With the roll out of PCX Plus, the Exchange's electronic trading system, the Exchange seeks to introduce a platform by which Lead Market Makers may either be present on the trading floor or may serve their role from a remote location. LMMs will retain their guaranteed participation allowances and opportunities to participate in open outcry should they choose to work from the physical trading floor. For those LMMs who choose to conduct their business from remote locations, they will not be able to inure the benefits of the current open outcry strategies and will be granted their guaranteed participation rights solely based upon the size and price that they disseminate via the PCX Plus System.

In order to allow LMMs to operate from a remote location, the Exchange is proposing a number of changes to its Rules. First, PCX Rule 6.32 is being amended to add LMMs to the definition of who may make transactions through the facilities of the Exchange. This change will allow LMMs who are not physically present on the trading floor to perform the duties and obligations from a remote location. Language in PCX Rule 6.32 is also being changed to allow for trades executed by an LMM through a facility of the Exchange, in addition to in-person trades, to be eligible to receive market maker margin. Presently only LMM trades that are executed on the floor of the Exchange or those that meet the criteria of PCX Rule 6.32(c) are eligible for market maker margin. Under the proposal, an LMM acting from a remote location would still be required to meet all of the obligations of an LMM as stated in PCX Rule 6.82.

Second, the Exchange is proposing to eliminate the prohibition in PCX Rule 6.82(a)(1) that Remote Market Makers (“RMMs”) are not eligible to act as LMMs from a location off the trading floor. The Exchange believes that this change is necessary to permit LMMs to operate from a remote location and to eliminate any uncertainty that may exist in interpreting PCX Rules. A firm that operates at the PCX can have different employees who function as RMM and LMM, however, under proposed amendments to PCX Rule 6.35(h)(4), these individuals are prohibited from trading the same option issues.

Fourth, as part of allowing Lead Market Makers to operate from a remote location, the Exchange is proposing to eliminate PCX Rule 6.82(h)(1). This rule currently allows the Lead Market Maker to perform Order Book Official functions. Since an Order Book Official is only present on the trading floor (PCX Plus does not contain a functionality similar to that which is performed by an Order Book Official), this function is not needed should a Lead Market Maker choose to operate from a remote location.

Finally, the provisions of the PCX Rules that permit Lead Market Makers to perform certain functions that require them to be physically present on the trading floor (i.e. PCX Rule 6.82(h)(3)) will only be permitted should the Lead Market Maker remain physically present on the trading floor. These functions will not be permitted should the Lead Market Maker decide to operate from a remote location.

III. Discussion

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations

thereunder applicable to a national securities exchange⁷ and, in particular, the requirements of Section 6 of the Act.⁸ Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,⁹ in that the proposal has been designed to promote just and equitable principles of trade, and to protect investors and the public interest.

A. Market Maker obligations

PCX Rule 6.32 is being amended to allow for trades executed by an LMM through a facility of the Exchange, in addition to in-person trades, to be eligible to receive market maker margin. The Commission believes that a Market Maker must have an affirmative obligation to hold itself out as willing to buy and sell options for its own account on a regular or continuous basis to justify this favorable treatment. The Commission believes that PCX's rules impose such affirmative obligations LMMs that choose to operate remotely and notes that under the proposal, an LMM acting from a remote location would still be required to meet all of the obligations of an LMM set forth in PCX Rule 6.82.

B. Affiliated RMMs and LMMs

In addition, the Exchange is proposing to eliminate the prohibition in PCX Rule 6.82(a)(1) that RMMs are not eligible to act as LMMs from a location off the trading floor. A firm that operates at the PCX can have different employees who function as RMM and LMM. Under the proposed new rules, however, these individuals would be

⁷ The Commission has considered the amended proposed rule change's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

⁸ 15 U.S.C. 78f.

⁹ 15 U.S.C. 78f(b)(5).

prohibited from trading the same option issues.¹⁰ The Commission believes that these limitations should help to reduce the opportunity for conflicts of interest.

C. Order Book Official Function

The Exchange is proposing to eliminate PCX Rule 6.82(h)(1), which allows LMMs to perform Order Book Official functions. Since an Order Book Official is only present on the trading floor, an LMM that chooses to operate from a remote location would not be able to fulfill this function. The Exchange has represented, and the Commission expects, that for those individuals who continue to trade via open outcry on the trading floor, the Exchange will provide the necessary staff to effectively supervise trading.¹¹

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹² that

¹⁰ See Proposed PCX Rule 6.35(h)(4).

¹¹ The Exchange has also represented that at this time no LMM is currently performing the functions of an Order Book Official nor has any LMM expressed an interest in doing so.

¹² 15 U.S.C. 78s(b)(2).

the proposed rule change (File No. SR-PCX-2005-31), as amended, is hereby approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹³

Margaret H. McFarland
Deputy Secretary

¹³ 17 CFR 200.30-3(a)(12).