

SECURITIES AND EXCHANGE COMMISSION
(Release No. 54017; File No. SR-Phlx-2006-38)

June 19, 2006

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Extend a Pilot Concerning Priority in Trades Involving Synthetic Option Orders

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 June 8, 2006, 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 proposed rule change pursuant Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6)⁴ thereunder, 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 extend for an additional one-year period a pilot concerning Exchange Rule 1033(e), which affords priority to synthetic option orders (as defined below) traded in an open-outcry over bids and offers in the trading crowd but not over bids (offers) of public customers on the limit order book and not over crowd participants who are willing to participate in the synthetic option order at the net debit or credit price. The rule applies to orders

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

for 100 contracts or more and is subject to a pilot program scheduled to expire on June 30, 2006. The Exchange proposes to extend the pilot through June 30, 2007.

The text of the proposed rule change is set forth below. Brackets indicate deletions; underline indicates new text.

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Bids And Offers --Premium

Rule 1033. (a) - (d) No change.

(e) Synthetic Option Orders. When a member holding a synthetic option order, as defined in Rule 1066, and bidding or offering on the basis of a total credit or debit for the order has determined that the order may not be executed by a combination of transactions at or within the bids and offers established in the marketplace, then the order may be executed as a synthetic option order at the total credit or debit with one other member, provided that, the member executes the option leg at a better price than the established bid or offer for that option contract, in accordance with Rule 1014. Subject to a pilot expiring June 30, 200[6] 7, synthetic option orders in open outcry, in which the option component is for a size of 100 contracts or more, have priority over bids (offers) of crowd participants who are bidding (offering) only for the option component of the synthetic option order, but not over bids (offers) of public customers on the limit order book, and not over crowd participants that are willing to participate in the synthetic option order at the net debit or credit price.

(f) - (i) 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 extend for a one-year period the pilot that facilitates the execution of an option order that is represented in the crowd together with a stock component, known under the Exchange's rules as a synthetic option order,⁵ which by virtue of the stock component may be difficult to execute without a limited exception to current Exchange priority rules. The pilot was originally adopted in July 2005⁶ and was extended for an additional six-month period, currently scheduled to expire June 30, 2006.⁷

⁵ Exchange Rule 1066(g) defines a synthetic option order as an order to buy or sell a stated number of option contracts and buy or sell the underlying stock or Exchange-Traded Fund Share in an amount that would offset (on a one-for-one basis) the option position. For example:

(1) Buy-write: an example of a buy-write is an order to sell one call and buy 100 shares of the underlying stock or Exchange-Traded Fund Share.

(2) Synthetic put: an example of a synthetic put is an order to buy one call and sell 100 shares of the underlying stock or Exchange-Traded Fund Share.

(3) Synthetic call: an example of a synthetic call is an order to buy (or sell) one put and buy (or sell) 100 shares of the underlying stock or Exchange-Traded Fund Share.

⁶ See Securities Exchange Act Release No. 52140 (July 27, 2005), 70 FR 45481 (August 5, 2005) (SR-Phlx-2005-31).

⁷ See Securities Exchange Act Release No. 53004 (December 22, 2005), 70 FR 72234 (December 29, 2005) (SR-Phlx-2005-78).

Currently, Exchange Rule 1033(e) provides that, if an Exchange member who is holding a synthetic option order and bidding or offering on a net debit or credit basis determines that such synthetic option order cannot be executed at the net debit or credit against the established bids and offers in the crowd, the member bidding for or offering the synthetic option on a net debit or credit basis may execute the synthetic option order with one other crowd participant, provided that the option portion of the synthetic option order is executed at a price that is better than the established bid or offer for the option. Thus, if the desired net debit or credit amount cannot be achieved by way of executing against the established bids and offers in the crowd, the member may elect to trade at the desired net debit or credit amount with one other member, provided that there is price improvement for the option component of the synthetic option order.

Exchange Rule 1033(e) affords synthetic option orders priority over bids (offers) of the trading crowd but not over bids (offers) of public customers on the limit order book and not over crowd participants that are willing to participate in the synthetic option order at the net debit or credit price. The effect of Exchange Rule 1033(e) is that a crowd participant bidding or offering for the synthetic option order has priority over other crowd participants that are bidding or offering only for the option component of the order. Exchange Rule 1033(e) applies only to synthetic option orders of 100 contracts or more.

In addition, Exchange Rule 1033(e) provides that members bidding and offering for synthetic option orders of 100 contracts or more do not have priority over bids (offers) of public customers on the limit order book.⁸ Therefore, if members of the trading crowd wish to trade a synthetic option order that is marketable against public customer orders on the limit order book,

⁸ See Exchange Rule 1080, Commentary .02.

public customers would have priority. Multiple public customer orders at the same price are accorded priority based on time.

The Exchange believes that the pilot, which provides a limited exception to the Exchange's priority rules only respecting controlled accounts⁹ competing at the same price, should enable Floor Brokers representing synthetic option orders to provide best executions to customers placing such orders and should enable the Exchange to provide liquid markets and compete for order flow in such orders.

As stated above, the pilot applies only to synthetic option orders in which the option component is for a size of 100 contracts or more that are represented in the trading crowd in open outcry and would be subject to a pilot program through June 30, 2007.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act¹⁰ in general, and furthers the objectives of Section 6(b)(5) of the Act¹¹ 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 adopting a limited exception to the Exchange's priority rules concerning synthetic option orders.

⁹ A controlled account includes any account controlled by or under common control with a broker-dealer. Customer accounts are all other accounts. Orders of controlled accounts are required to yield priority to customer orders when competing at the same price. Orders of controlled accounts generally are not required to yield priority to other controlled account orders. See Exchange Rule 1014(g)(i)(A).

¹⁰ 15 U.S.C. 78f(b).

¹¹ 15 U.S.C. 78f(b)(5).

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

The Exchange does not believe that the proposed rule change would 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

Because the foregoing 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 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, it has become effective pursuant to Section 19(b)(3)(A) of the Act¹² and Rule 19b-4(f)(6) thereunder.¹³ 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 furtherance of the purposes of the Act.

The Exchange requests that the Commission waive the 5-day pre-filing period and 30-day operative period under Rule 19b-4(f)(6)(iii)¹⁴ in order to ensure the continuity of the pilot. The Commission has waived the 5-day pre-filing requirement for this proposed rule change. In addition, the Commission believes that it is consistent with the protection of investors and the

¹² 15 U.S.C. 78s(b)(3)(A).

¹³ 17 CFR 240.19b-4(f)(6).

¹⁴ 17 CFR 240.19b-4(f)(6)(iii).

public interest to waive the 30-day operative delay.¹⁵ The Commission believes that the waiver of the 30-day operative delay will allow the Exchange to continue, without interruption, the existing operation of its pilot until June 30, 2007.

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. Please include File Number SR-Phlx-2006-38 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-Phlx-2006-38. 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

¹⁵ For purposes only of waiving the 30-day operative delay of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

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-2006-38 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.¹⁶

Nancy M. Morris
Secretary

¹⁶ 17 CFR 200.30-3(a)(12).