

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-54746; File No. SR-Phlx-2006-71)

November 14, 2006

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Clarifying its Payment for Order Flow Program as it Relates to Order Flow Providers

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 November 7, 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, II, and III below, which Items have been prepared by the Exchange. The Phlx has designated this proposal as one changing a fee imposed by the Phlx under Section 19(b)(3)(A)(ii) of the Act<sup>3</sup> and Rule 19b-4(f)(2) 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 clarify, in connection with the Exchange’s payment for order flow program,<sup>5</sup> who may receive payment for order flow funds that are assessed by the Exchange on

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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)(ii).

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

<sup>5</sup> The Exchange’s payment for order flow program is currently in effect until May 27, 2007. See Securities Exchange Act Release No. 53841 (May 19, 2006), 71 FR 30461 (May 26, 2006) (SR-Phlx-2006-33).

members and member organizations<sup>6</sup> and are disbursed, as described in detail below, based on the instructions of the specialist units<sup>7</sup> and Directed ROTs.<sup>8</sup>

The Exchange states that under its current payment for order flow program, any available payment for order flow funds are disbursed by the Exchange according to the instructions of the specialist units and Directed ROTs. A specialist unit or Directed ROT must certify to the Exchange that payment for order flow funds directed by either of them to be paid to Order Flow Providers reflect payment arrangements entered into by the specialist unit or Directed ROT and

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<sup>6</sup> The Exchange states that, specifically, the payment for order flow fee is assessed on specialists/specialist units and Directed Registered Options Traders (“Directed ROTs”) who participate in the Exchange’s payment for order flow program, and Registered Options Traders (“ROT”).

<sup>7</sup> The Exchange states that it uses the terms “specialist” and “specialist unit” interchangeably herein.

<sup>8</sup> The Exchange states that Directed ROTs are either Streaming Quote Traders (“SQTs”) or Remote Streaming Quote Traders (“RSQTs”) that receive Directed Orders. An SQT is an Exchange ROT who has received permission from the Exchange to generate and submit option quotations electronically through an electronic interface with AUTOM via an Exchange approved proprietary electronic quoting device in eligible options to which such SQT is assigned. AUTOM is the Exchange’s electronic order delivery, routing, execution, and reporting system, which provides for the automatic entry and routing of equity option and index option orders to the Exchange trading floor. See Exchange Rules 1014(b)(ii) and 1080). An RSQT is an Exchange ROT that is a member or member organization of the Exchange with no physical trading floor presence who has received permission from the Exchange to generate and submit option quotations electronically through AUTOM in eligible options to which such RSQT has been assigned. An RSQT may only submit such quotations electronically from off the floor of the Exchange. An RSQT may only trade in a market making capacity in classes of options in which he is assigned. See Exchange Rule 1014(b)(ii)(B). See Securities Exchange Act Release Nos. 51126 (February 2, 2005), 70 FR 6915 (February 9, 2005) (SR-Phlx-2004-90) and 51428 (March 24, 2005), 70 FR 16325 (March 30, 2005) (SR-Phlx-2005-12). The Exchange states that the term “Directed Order” means any customer order to buy or sell, which has been directed to a particular specialist, RSQT, or “SQT” by an Order Flow Provider (defined below). The provisions of Phlx Rule 1080(l) are in effect for a one-year pilot period to expire on May 27, 2007. See Securities Exchange Act Release No. 53870 (May 25, 2006), 71 FR 31251 (June 1, 2006) (SR-Phlx-2006-27).

the Order Flow Provider. The term “Order Flow Provider” is defined as any member or member organization that submits, as agent, customer orders to the Exchange.<sup>9</sup>

The Exchange states that in addition to the Order Flow Providers defined above, there are additional order flow providers who are not members or member organizations of the Exchange who also route orders to the Exchange, but do so through a member or member organization. In these situations, the Exchange proposes to clarify that the specialist unit or Directed ROT may instruct the Exchange to direct payment to these order flow providers, in the same way that is done for Order Flow Providers, if they have entered into payment arrangements with a specialist unit or Directed ROT to send order flow to the Exchange. Thus, specialist units and Directed ROTs may instruct the Exchange to direct payment for order flow funds to order flow providers who are members, non-members, member organizations, or non-member organizations, provided, the requirements relating to certification, as described above, have been met. The Exchange notes that such order flow providers may arrange for the member organizations through which they route orders (referred to as “Order Flow Providers” in this proposal) to receive their payment for order flow payments and forward those funds to such non-member order flow provider. Although order flow providers may do this, many have chosen to receive payments directly, such that this proposal seeks to codify that practice.

It is the Exchange's understanding that the arrangement to disburse payment for order flow funds to non-member payment for order flow providers, in the same way that it is done for Order Flow Providers (who are members or member organizations of the Exchange), is not unacceptable to the Order Flow Providers. To codify this practice, the Exchange intends to amend its certification form to require that the specialists and Directed ROTs that request

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<sup>9</sup> See Exchange Rule 1080(l).

payment for order flow funds certify, if applicable, that payments sent directly to a non-member payment for order flow provider is not unacceptable to the Order Flow Provider through whom the orders are routed.

In addition, consistent with current practice, Directed ROTs and specialists who request that payments be made to order floor providers would be required to make, keep current, and preserve all books and records relating to payment for order flow arrangements.<sup>10</sup>

Below is the text of the proposed rule change. Proposed additions are underlined.

### **SUMMARY OF EQUITY OPTION CHARGES (p. 3/6)**

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#### **EQUITY OPTION PAYMENT FOR ORDER FLOW FEES\***

- (1) For trades resulting from either Directed or non-Directed Orders that are delivered electronically and executed on the Exchange: Assessed on ROTs, specialists and Directed ROTs on those trades when the specialist unit or Directed ROT elects to participate in the payment for order flow program.\*\*\*
- (2) No payment for order flow fees will be assessed on trades that are not delivered electronically.

QQQQ (NASDAQ-100 Index Tracking Stock <sup>SM</sup> )	\$0.75 per contract
Remaining Equity Options	\$0.70 per contract

See Appendix A for additional fees.

\*Assessed on transactions resulting from customer orders and are available to be disbursed by the Exchange according to the instructions of the specialist units/specialists or Directed ROTs to order flow providers who are members or member organizations, who submit, as agent, customer

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<sup>10</sup> See Exchange Rule 760, Maintenance, Retention and Furnishing of Books, Records, and Other Information.

orders to the Exchange or non-members or non-member organizations who submit, as agent, customer orders to the Exchange through a member or member organization who is acting as agent for those customer orders. This proposal will be in effect for trades settling on or after October 1, 2005 and will remain in effect as a pilot program that is scheduled to expire on May 27, 2007.

\*\*\*Any excess payment for order flow funds billed but not utilized by the specialist or Directed ROT will be carried forward unless the Directed ROT or specialist elects to have those funds rebated to the applicable ROT, Directed ROT or specialist on a pro rata basis, reflected as a credit on the monthly invoices. At the end of each calendar quarter, the Exchange will calculate the amount of excess funds from the previous quarter and subsequently rebate excess funds on a pro-rata basis to the applicable ROT, Directed ROT or specialist who paid into that pool of funds.

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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 Exchange states that the purpose of amending the definition of Order Flow Providers<sup>11</sup> as set forth in the Exchange's payment for order flow program is to clarify that the available payment for order flow funds that are disbursed by the Exchange according to instructions of the specialist units and Directed ROTs to Order Flow Providers, may include order flow providers that are not members or member organizations of the Exchange. Consistent with the Exchange's current payment for order flow program, the Exchange would not be involved in the determination of the terms governing the orders that qualify for payment or the amount of any payment. The Exchange states that it would merely be providing administrative support for the payment for order flow program by making the payment for order flow payments on behalf of, and at the direction of, the specialist units or Directed ROTs.

Currently, the term "Order Flow Provider" is defined in Exchange Rule 1080(l) as any member or member organization that submits, as agent, customer orders to the Exchange. The Exchange represents that it is not seeking to change the definition as set forth in Exchange Rule 1080(l). As described above, the Exchange merely intends to clarify that in addition to the defined term of Order Flow Provider, order flow providers may include non-members or non-member organizations that submit, as agent, customer orders to the Exchange through a member or member organization. The Exchange is not changing any other aspect of its payment for order flow program pursuant to this filing. The Exchange states that the payment for order flow fee would continue to be assessed on Exchange members, specifically specialists and Directed ROTs who participate in the Exchange's payment for order flow program, in addition to ROTs.

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<sup>11</sup> See Exchange Rule 1080(l).

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>12</sup> in general, and furthers the objectives of Sections 6(b)(4) and 6(b)(5) of the Act<sup>13</sup> in particular, in that it is an equitable allocation of reasonable dues, fees, and other charges among Exchange members or other persons using the Exchange's facilities<sup>14</sup> and 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 acknowledging that not all order flow providers are members of Phlx, but nonetheless otherwise qualify to have payment for order flow funds, which are assessed on Exchange members and member organizations, directed to them at the direction of the specialist unit or Directed ROT.

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

The Exchange does not believe that the proposed rule change 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.

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<sup>12</sup> 15 U.S.C. 78f(b).

<sup>13</sup> 15 U.S.C. 78f(b)(4) – (5).

<sup>14</sup> As stated above, the Exchange notes that the payment for order flow fee is only assessed on Exchange members or member organizations. However, a specialist unit or Directed ROT may instruct the Exchange to direct the funds collected from this fee to an order flow provider (a non-member/member organization of the Exchange).

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing proposed rule change has been designated as a fee change pursuant to Section 19(b)(3)(A)(ii) of the Act<sup>15</sup> and Rule 19b-4(f)(2)<sup>16</sup> thereunder, because it establishes or changes a due, fee, or other charge imposed by the Exchange. Accordingly, the proposal will take effect upon filing with the Commission. At any time within 60 days of the filing of such 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.

### 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](mailto:rule-comments@sec.gov). Please include File Number SR-Phlx-2006-71 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-2006-71. 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

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

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-2006-71 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>17</sup>

Nancy M. Morris  
Secretary

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<sup>16</sup> 17 CFR 240.19b-4(f)(2).

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