

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-49467; File No. SR-Phlx-2004-17)**

**March 24, 2004**

**Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by the Philadelphia Stock Exchange, Inc. Relating to Equity and Index Option Fees**

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 February 27, 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 Phlx. On March 23, 2004, the Phlx filed an amendment to the proposed rule change.<sup>3</sup> 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 Phlx proposes to amend its schedule of dues, fees and charges to: (1) extend its current specialist unit fixed monthly fee (“fixed monthly fee”) and related Nasdaq-100

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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> See letter from Cynthia Hoekstra, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated March 22, 2004 (“Amendment No. 1”). In Amendment No. 1, the Phlx clarified that the election of the fixed monthly fee program applies to the program’s entire six-month period; explained that the volume used to determine the fixed monthly fee is determined on a per specialist unit basis; explained that in the event that a new specialist unit acquires the QQQ options and elects to enter the fixed monthly fee program from March 1, 2004 through August 31, 2004, the Exchange will file a separate proposed rule change to set forth the applicable months for the calculation of the volume; and made some minor changes to clarify the text of the proposed rule change.

Index Tracking Stock (“QQQ”)<sup>SM 4</sup> license fee for a six-month period to those specialist units enrolled in the Exchange’s fixed monthly fee program;<sup>5</sup> (2) offer a new fixed monthly fee program for a six-month period to those specialist units who are not enrolled in the current specialist unit fixed monthly fee program; and (3) make minor amendments to the fixed monthly fee program, such as allowing for specialist units to opt out of the fixed monthly fee program during the six-month period. The text of the proposed rule change, as amended, is available at the Phlx and at the Commission.

#### Current Fee Structure Regarding the Fixed Monthly Fee and QQQ License Fee

Currently, the Exchange offers specialist units<sup>6</sup> the opportunity to elect to pay a fixed monthly fee in lieu of paying fees currently in effect for equity option and index option transaction charges and equity option specialist deficit (shortfall) fee (“shortfall fee”) (collectively “variable fees”).<sup>7</sup> The fixed monthly fee program applies to specialist

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<sup>4</sup> The Nasdaq-100®, Nasdaq-100 Index®, Nasdaq®, The Nasdaq Stock Market®, Nasdaq-100 Shares<sup>SM</sup>, Nasdaq-100 Trust<sup>SM</sup>, Nasdaq-100 Index Tracking Stock<sup>SM</sup>, and QQQ<sup>SM</sup> are trademarks or service marks of The Nasdaq Stock Market, Inc. (“Nasdaq”) and have been licensed for use for certain purposes by the Phlx pursuant to a License Agreement with Nasdaq. The Nasdaq-100 Index® (the “Index”) is determined, composed, and calculated by Nasdaq without regard to the Licensee, the Nasdaq-100 Trust<sup>SM</sup>, or the beneficial owners of Nasdaq-100 Shares<sup>SM</sup>. According to the Phlx, Nasdaq has complete control and sole discretion in determining, comprising, or calculating the Index or in modifying in any way its method for determining, comprising, or calculating the Index in the future.

<sup>5</sup> See Securities Exchange Act Release No. 48459 (September 8, 2003), 68 FR 54034 (September 15, 2003) (SR-Phlx-2003-61).

<sup>6</sup> The Exchange uses the terms “specialist” and “specialist unit” interchangeably herein.

<sup>7</sup> The fixed monthly fee program does not affect additional charges, such as non-transaction and membership-related charges listed on Appendix A of the Exchange’s schedule of dues, fees and charges. See Securities Exchange Act Release No. 48459 (September 8, 2003), 68 FR 54034 (September 15, 2003) (SR-Phlx-2003-61).

units who have been actively trading an equity option or index option book on the Phlx trading floor in their capacity as a specialist unit in at least one equity option or index option book for at least one year from September 1, 2002. In addition, a \$0.10 charge per contract side for specialist unit transactions in the QQQ equity options (“QQQ license fee”) is imposed if the specialist unit elects to pay the fixed monthly fee. This fee is in addition to the fixed monthly fee.<sup>8</sup> The current fixed monthly fee and QQQ license fee were scheduled to be in effect through February 29, 2004. Phlx proposes to extend the current fixed monthly fee and related QQQ license fee for an additional six-month period until August 31, 2004.

#### Proposed New Fixed Monthly Fee

In addition, the Phlx proposes to offer a new fixed monthly fee program to specialist units who are not enrolled in the current program, but who have been trading an equity option or index option book on the Phlx trading floor in their capacity as a specialist unit with Phlx equity option or index option transactions in at least one equity option or index option book for at least nine months as of March 1, 2004. These specialist units may elect to enter into the proposed fixed monthly fee program and pay the fixed monthly fee, in lieu of the variable fees, based on the calculation listed below:

1. Compute the equity options and index options volume that each specialist unit transacted in October 2003, November 2003 and December 2003 (“Volume”) provided it has been a Phlx specialist unit for at least nine months as of March 1, 2004;

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<sup>8</sup> The \$0.10 fee does not apply if the specialist unit elects to pay the current equity option and index option transaction charges, and the applicable shortfall fees.

2. Multiply the Volume by the specialist transaction charges currently in effect (i.e., \$0.21 per contract for equity options and \$0.24 per contract for index options).  
  
The total of these transaction charges are added together to arrive at a total for the period (“Total Transaction Charges”);<sup>9</sup>
3. For equity options, calculate for that month the shortfall fee at the current rate (currently 12%, with a monthly limit of \$10,000 per option, if applicable) for the months of October 2003, November 2003 and December 2003;<sup>10</sup>
4. Add the Total Transaction Charges with the shortfall fee calculation, if applicable, divide the total by three, and multiply the quotient by 1.062, which will produce the fixed monthly fee.

For both the extension of the current fixed monthly fee and the proposed fixed monthly fee, a specialist unit or its successor organization may, by the 15<sup>th</sup> day of the

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<sup>9</sup> This calculation is comparable to the current fixed monthly fee program except in the case of a specialist unit trading QQQ options. Currently for QQQ options, the May 2003 and June 2003 QQQ equity options volume is subtracted from the May 2003 and June 2003 total equity and index option volumes; that figure is then multiplied by the current equity option transaction charge and then added to the product of \$0.11 multiplied by the May 2003 and June 2003 QQQ equity options volume (the \$0.10 license fee owed to Nasdaq subtracted from the \$0.21 charge). Steps 3 and 4 are then followed, using the applicable months of May 2003 and June 2003. Then, all QQQ equity option transactions to which the specialist unit is a party incurs an additional \$0.10 per contract, which is added to the specialist unit’s fixed fees. This calculation is used due to the fact that the specialist unit currently trading the QQQ options has elected the fixed monthly fee program and therefore there are no changes to the QQQ options calculation at this time. In the unlikely event that a new specialist unit acquires the QQQ options from March 1, 2004 through August 31, 2004 and elects to enter the fixed monthly fee program during this time period, the Exchange will file a separate proposed rule change to set forth the applicable volume statistics.

<sup>10</sup> See Securities Exchange Act Release Nos. 48207 (July 22, 2003), 68 FR 44558 (July 29, 2003) (notice of filing and immediate effectiveness of SR-Phlx-2003-47) and 48206 (July 22, 2003), 68 FR 44555 (July 29, 2003) (notice of filing and immediate effectiveness of SR-Phlx-2003-45).

billing month, select the fixed monthly fee applicable to that specialist unit for subsequent months.<sup>11</sup> A specialist unit being charged the fixed monthly fee may return to the variable fee method, if it notifies the Exchange, in writing, thirty days prior to the beginning of the calendar month in which the specialist unit wishes to return to the variable fee method.<sup>12</sup>

The other methodologies relating to the fixed monthly fee, such as acquiring an equity option or index option book already traded on the Exchange, obtaining a book as a result of a new Exchange listing or trading an equity option or index option book that does not have a complete two month volume, as outlined on the Exchange's fee schedule, will remain unchanged.<sup>13</sup>

The Exchange also proposes to make minor amendments to its fee schedule to clarify existing language and to delete superfluous language.

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<sup>11</sup> For example, if a specialist unit wishes to select the fixed monthly fee beginning April 1, 2004, it must notify the Exchange in writing by March 15, 2004. The fixed monthly fee will not be implemented retroactively. If the 15<sup>th</sup> of a month is not a business day, the specialist unit may select the fixed monthly fee program by the next business day. The requirement that a specialist unit elect the fixed rate by the 15<sup>th</sup> of the billing month will be waived for the first month. Therefore, due to the fact that this proposal is scheduled to become effective for transactions settling on or after March 1, 2004, specialists will have the opportunity to select the applicable fixed monthly fee until 9:00 a.m. on March 1, 2004.

<sup>12</sup> The Exchange intends to distribute administrative procedures to the specialist units to follow in connection with choosing the fixed monthly fee or returning to the variable fee method.

<sup>13</sup> See Securities Exchange Act Release No. 48459 (September 8, 2003), 68 FR 54034 (September 15, 2003) (SR-Phlx-2003-61). While the calculation methodology will remain the same, the applicable time periods (*i.e.*, May and June 2003 or October, November, and December 2003) will be used in the calculations.

The current fixed monthly fee and related QQQ license fee and the proposed new fixed monthly fee as described in this proposal are scheduled to become effective for transactions settling on or after March 1, 2004 through August 31, 2004.

**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 allow the current fixed monthly fee program and the related QQQ license fee to continue for an additional six-month period and allow additional specialist units the opportunity to elect the fixed monthly fee program. According to the Exchange, the fixed monthly fee program should create an incentive for specialist units to bring in more business, above the fixed monthly fee amount, which would be free of additional transaction charges assessed on specialist units. Additional order flow may generate transaction fees on the contra side that, in turn, may generate additional revenue for the Exchange. The additional six-month period should also give the Exchange the opportunity to further evaluate the fixed monthly fee program. According to the Phlx, making minor amendments to its monthly fixed fee program and to its fee schedule to clarify existing language and delete superfluous

language should minimize member confusion relating to the implementation of the fixed monthly fee.

2. Statutory Basis

The Exchange believes that its proposal to amend its schedule of dues, fees and charges is consistent with Section 6(b) of the Act<sup>14</sup> in general, and furthers the objectives of Section (6)(b)(4) of the Act<sup>15</sup> in particular, in that it is an equitable allocation of reasonable dues, fees, and other charges among Exchange members. The Exchange continues to believe that the fixed monthly fee program offers a fee alternative that has attracted additional business to the Exchange and therefore believes that the program should be extended for an additional six-month period. The Exchange believes that offering the fixed monthly fee program to additional specialist units should similarly attract additional business. The Exchange has determined to use volumes from a more recent time period (October through December 2003 as opposed to May through June 2003) to calculate the applicable fee for specialist units selecting the fixed monthly fee for the first time, in order to utilize a more current benchmark. The Exchange believes that it is reasonable and fair to apply to specialists not enrolled in the current fixed monthly fee program volumes from a more recent time period than for specialists previously subject to the program, because specialists previously subject to the program have known and relied upon the way the program operated in the original pilot to attract order flow and build their business model. The Exchange believes that if it were to change the time periods from which the volumes are calculated, particularly if the resulting fixed monthly fee is higher, it would change the specialist units' expectation and

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<sup>14</sup> 15 U.S.C. 78f(b).

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

adversely affect their business decisions with a financial penalty for accomplishing the objectives of bringing new business to the Exchange. Therefore the Exchange believes that offering the fixed monthly fee program to additional specialist units, although with volume statistics attributable to a more recent time period, should give them the opportunity to enter the fixed monthly fee program based on more recent activity which, in turn, should reflect their current business objectives.

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

The Phlx does not believe that the proposed rule change will impose any burden on competition.

**C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others**

Written comments were neither solicited nor received with respect to the proposed rule change.

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

The foregoing proposed rule change, as amended, has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act<sup>16</sup> and Rule 19b-4(f)(2)<sup>17</sup> thereunder, because it changes a fee imposed by the Exchange. 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

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<sup>16</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

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

interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.<sup>18</sup>

#### **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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Comments may also be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-Phlx-2004-17. 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, comments should be sent in hardcopy or by e-mail but not by both methods. 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 will also be available for inspection and copying at the

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<sup>18</sup> For purposes of calculating the sixty-day abrogation period, the Commission considers the period to commence on March 23, 2004, the date on which the Phlx filed Amendment No. 1.

principal office of the Phlx. All submissions should refer to File No. SR-Phlx-2004-17 and should be submitted by [insert date 21 days from date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>19</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>19</sup> 17 CFR 200.30-3(a)(12).