

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-49523; File No. SR-Phlx-2003-71)

April 2, 2004

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Granting Approval to Proposed Rule Change Relating to Participation Guarantees for Floor Brokers Representing Crossing and Facilitation Orders in Index Options

On October 20, 2003, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), 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> a proposed rule change to amend Phlx Rule 1064, Crossing, Facilitation and Solicited Orders, with respect to index options. On January 9, 2004, Phlx filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The proposed rule change, as amended, was published for comment in the Federal Register on February 18, 2004.<sup>4</sup> The Commission received no comments on the proposal.

Phlx Rule 1064 sets forth, among other things, the procedures by which a floor broker holding an option order ("original order") may cross it with another order or orders he or she is holding, or, in the case of a public customer order, with a contra side order provided by the originating firm from its own proprietary account ("facilitation order"). Under certain conditions, Rule 1064 provides "participation guarantees" in such crossing or facilitation transactions, entitling the floor broker to cross a certain percentage

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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 Richard S. Rudolph, Director and Counsel, Phlx, to Ira Brandriss, Special Counsel, Division of Market Regulation, Commission, dated January 8, 2004.

<sup>4</sup> See Securities Exchange Act Release No. 49215 (February 9, 2004), 69 FR 7662 ("Notice").

of the original order with the other order or orders ahead of members of the trading crowd.<sup>5</sup> These participation guarantees currently apply to transactions in equity options only. The Exchange proposes to amend Rule 1064 to provide a participation guarantee for trading in index options, and to set the guaranteed percentage in such options at 20%.<sup>6</sup>

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange,<sup>7</sup> and, in particular, the requirements of Section 6(b)(5) of the Act.<sup>8</sup> The Exchange believes that establishing a participation guarantee of 20% for crossing and facilitation transactions in index options would make the Exchange more competitive by providing an incentive to index options order flow providers to bring order flow to the Exchange. The Commission believes that participation guarantees are reasonable and within the business judgment of the Exchange, as long as they do not restrict competition

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<sup>5</sup> The percentage of the order that a floor broker is entitled to cross after all public customer orders have been satisfied is: (1) 20% of the remaining contracts in the order if the order is traded at the best bid or offer given by the crowd in response to the floor broker's initial request for a market; and (2) 40% of the remaining contracts in the order if the order is traded between the best bid or offer given by the crowd in response to the floor broker's initial request for a market. These guarantees apply when the original order is of an eligible size as determined by the Phlx Options Committee on an option-by-option basis, but in no case less than 500 contracts. See Phlx Rule 1064, Commentary .02(ii)-(iii).

<sup>6</sup> The 20% guarantee would apply whether the order is traded at or between the best bid or offer given by the crowd in response to the floor broker's initial request for a market. All other provisions in Rule 1064 concerning participation guarantees in equity options would apply to index options in the same manner as they apply to equity options. See Notice.

<sup>7</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

and do not harm investors.<sup>9</sup> The Commission has found, with respect to participation guarantees in other contexts, that guarantees of as much as 40% of an order in options trading are not inconsistent with statutory standards of competition and free and open markets.<sup>10</sup>

The Commission notes that, pursuant to Phlx Rule 1064, Commentary .02(vi), if a crossing or facilitation trade takes place in a situation in which the specialist is entitled to an Enhanced Specialist Participation (specialist guarantee), the percentage received by the specialist, combined with the percentage crossed by the floor broker, may be no more than 40% of the original order (after public customer orders have been satisfied).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act<sup>11</sup>, that the proposed rule change (File No. SR-Phlx-2003-71) be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>9</sup> See, e.g., Securities Exchange Act Release No. 47729 (April 24, 2003), 68 FR 23344 (May 1, 2003).

<sup>10</sup> See, e.g., Securities Exchange Act Release Nos. 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000) at 11398; and 43100 (July 31, 2000), 65 FR 48778 (August 9, 2000) at notes 96-99 and accompanying text.

<sup>11</sup> 15 U.S.C. 78s(b)(2).

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