

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-49587; File No. SR-Phlx-2003-54)

April 21, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 by the Philadelphia Stock Exchange, Inc. to Amend Rules Relating to the Minimum Net Capital for Specialists in Index Fund Shares

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on October 20, 2003, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On March 29, 2004, the Phlx amended the proposal.<sup>3</sup> Amendment No. 1 completely replaces and supersedes the original filing. 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 add a new subsection (B) to Exchange Rule 703(a)(v), which would establish a minimum net capital requirement of \$1,000,000 for specialists in Index Fund Shares. The text of the proposed rule change is below. Proposed new language is in italics.

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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 March 26, 2004 letter from Mark I. Salvacion, Director and Counsel, Phlx, to Rachael Grad, Attorney, Division of Market Regulation, SEC and attachments ("Amendment No. 1").

## Rule 703(a)

(i)-(iv) No change.

(v) (A) An assigned Specialist in Trust Shares, as defined in Rule 803(i), that are listed on the Exchange, shall be required to maintain a minimum of \$1,000,000 in net capital. The assigned Specialist shall immediately inform the Examinations Department upon failure to be in compliance with such requirement. (B) An assigned Specialist in Index Fund Shares, as defined in Rule 803(l)(2)(A), that are listed on the Exchange, shall be required to maintain a minimum of \$1,000,000 in net capital. The assigned Specialist shall immediately inform the Examinations Department upon failure to be in compliance with such requirement. The Exchange may waive the financial requirements of this Rule 703(a)(v) in unusual circumstances.

(vi)-(ix) No change.

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 increase the minimum net capital requirement for specialists in Index Fund Shares because of the unique risks associated with Index Fund Shares.<sup>4</sup> Currently, Exchange Rule 703(a)<sup>5</sup> sets forth certain categories of net capital requirements for various types of member organizations, based on the type of security or activity in which the member organization engages. For example, subsection (v) of Exchange Rule 703(a)<sup>6</sup> provides that an assigned specialist in Trust Shares is required to maintain a minimum of \$1,000,000 in net capital. Because of the potential risks associated with trading Trust Shares, specialists in Trust Shares are expected to make a greater financial commitment for the privilege of acting as a specialist in Trust Shares.<sup>7</sup>

Index Fund Shares that are to be listed on the Exchange, just as Trust Shares, are expected to entail a substantial financial commitment on the part of the specialist

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<sup>4</sup> "Index Fund Share" is defined in Exchange Rule 803(l)(2)(A) as a "security (I) that is issued by an open-end management investment company based on a portfolio of stocks that seeks to provide investment results that correspond generally to the price and yield performance of specified foreign or domestic stock index; (II) that is issued by such an open-end management investment company in a specified aggregate minimum number in return for a deposit of specified number of shares of stock and/or a cash amount with a value equal to the next determined net asset value; and (III) that, when aggregated in the same specified minimum number, may be redeemed at a holder's request by such open-end management investment company which will pay to the redeeming holder the stock and/or cash with a value equal to the next determined net asset value."

<sup>5</sup> See Phlx Rule 703(a).

<sup>6</sup> See Phlx Rule 703(a)(v).

<sup>7</sup> See Securities Exchange Act Release No. 45129 (December 4, 2001), 66 FR 64331 (December 12, 2001)(SR-Phlx-99-41)(Order approving \$1 million minimum net capital requirement for specialists in Trust Shares).

assigned to them because most, if not all, index fund shares are created and redeemed in large blocks called "creation units" which may be as large as 50,000 shares per unit. Because the potential risks associated with Index Fund Shares are no less than the risks associated with Trust Shares, the proposed rule change establishes a minimum net capital requirement of \$1,000,000 for specialists in Index Fund Shares. As such, proposed Rule 703(a)(v)(B) is substantially similar to current Rule 703(a)(v), which would be renumbered Rule 703(a)(v)(A). The Exchange believes that imposing a higher net capital requirement is one way to ensure that the Index Fund Share specialist can carry out his or her duties to maintain a fair and orderly market. Moreover, the Exchange believes that the higher minimum net capital requirement for Index Fund Shares pursuant to proposed Section 703(a)(v)(B) will ensure that only sufficiently capitalized firms will apply to become specialists in Index Fund Shares.

The proposed higher minimum net capital requirement for specialists in Index Fund Shares listed and traded on the Phlx on a primary basis would not apply to Index Fund Shares traded on an unlisted trading privileges basis. This is due to the fact that specialists, in the case of Index Fund Shares traded on an unlisted trading privileges basis, do not generally undertake the same financial commitments to create and redeem Index Fund Shares as do specialists in their primary market.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>8</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>9</sup> in particular, in that it

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

<sup>9</sup> 15 U.S.C. 78f(b)(5).

is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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.

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

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

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which the Exchange consents, the Commission will:

(A) by order approve such proposed rule change; or

(B) institute proceedings to determine whether the proposed rule change

should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposal 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-2003-54 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-Phlx-2003-54. 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. 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 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-2003-54 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>10</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>10</sup> 17 CFR 200.30-3(a)(12).