

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-52495; File No. SR-Phlx-2005-14)

September 22, 2005

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Granting Approval to Proposed Rule Change and Amendment No. 1 Thereto Relating to Order Matching at the Opening in PACE

I. Introduction

On March 10, 2005, 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 229 to permit the PACE System<sup>3</sup> to modify the opening process to match certain orders, described below, to each other, where possible, instead of matching such orders with the specialist. On July 28, 2005, the Phlx filed Amendment No. 1 to the proposed rule change.<sup>4</sup> The proposed rule change, as amended, was published for comment in the Federal Register on August 17, 2005.<sup>5</sup> The Commission received no comments on the proposal. This order approves the proposed rule change, as amended.

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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> PACE is the Exchange’s automated order routing, delivery, execution and reporting system for equities. See Phlx Rule 229.

<sup>4</sup> Amendment No. 1, which replaced and superseded the original filing in its entirety, included additional text in the purpose section to further clarify the description and operation of the proposed rule change, and also included a minor edit to the text of Phlx Rule 229.

<sup>5</sup> See Securities Exchange Act Release No. 52239 (August 11, 2005), 70 FR 48457 (“Notice”).

## II. Description of the Proposal

Currently, eligible market and limit orders received before the opening of the listing market<sup>6</sup> are guaranteed an execution against the specialist to whom the order was directed (the “Directed Specialist”)<sup>7</sup> at the open price. The Exchange has proposed to modify the PACE System to match certain eligible orders received before the open against other eligible contra-side orders (as available) at the opening price, rather than execute such orders against the Directed Specialist.<sup>8</sup> The Directed Specialist would continue to provide executions for any orders that would be ineligible for the proposed matching feature (as described below) and also for any imbalance of directed orders resulting from the proposed matching feature. However, the proposal would have the effect of removing the Directed Specialist from interaction with orders received before the open when such orders would be eligible for matching against other orders. The proposal also modifies the conditions for an order to be guaranteed an automatic execution at the listing market’s opening price (whether matched against another order or against the Directed Specialist).

### Automatic Execution Guarantee

Under the proposal, in order to be guaranteed an automatic execution at the listing market’s opening price, market orders that are of a size equal to or smaller than the Directed Specialist’s automatic execution guarantee size would need to be entered anytime before the

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<sup>6</sup> The term “listing market” refers to the applicable New York listing market.

<sup>7</sup> The term “Directed Specialist” has the same meaning as in Phlx Rule 229A(b)(3), when there is more than one specialist assigned in a security. When there is only one specialist assigned in a security, the term Directed Specialist means that sole specialist.

<sup>8</sup> Under the proposal, the Exchange’s matching algorithm would sort eligible orders by time priority and descending volume, thereby minimizing the number of different orders that any one order could match against.

actual opening of the applicable listing market, but market orders that are larger than the Directed Specialist's automatic execution guarantee size would need to be entered at least two minutes before the actual opening of the listing market.<sup>9</sup> Limit orders would need to be entered at least two minutes prior to the actual opening on the listing market and to be traded-through by the listing market's opening price in order to receive the automatic execution guarantee. Neither market orders nor limit orders would be eligible for an automatic execution guarantee at the listing market's opening price if they are marked sell short or laid-off by the Directed Specialist.

#### Orders Types Eligible for Matching

Under the proposal, only round-lot market and limit orders would be eligible for matching at the opening price of the listing market. Other order types would not be eligible for the matching feature and would continue to be executed against the Directed Specialist, including: odd-lot orders, partial round-lot all-or-none orders, the odd-lot portion of partial round-lot eligible orders, and round-lot all-or-none orders when a single contra-side order with sufficient volume is not available. In addition, the imbalance of any directed orders that, although eligible for matching, could not match against other orders due to the lack of available contra-orders would be executed against the Directed Specialist.

#### Other Changes

Finally, the proposal would delete existing language in Phlx Rule 229, Supplementary Material .10(b), relating to the size of market and limit orders and the receipt time required to receive the opening price, since the treatment of such orders will be covered in Supplementary Materials .06 and .10(a), and it would also delete Supplementary Material .11 relating to the

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<sup>9</sup> Under the proposal, a Directed Specialist could elect to adopt a shorter time threshold for the receipt of orders in all securities traded by the Directed Specialist.

refusal of orders, as the Phlx believes that specialists today have sufficient methods available to them to manage the risk associated with orders received before the opening.

### III. Discussion and Commission Findings

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>10</sup> In particular, the Commission believes that the proposal is consistent with Section 6(b)(5) of the Act,<sup>11</sup> which requires that the rules of an exchange be designed to promote just and equitable principles of trade, to perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Commission notes that the proposal would remove all size restrictions on orders guaranteed an automatic execution at the opening price, provided that such orders are received within a certain time before the opening of the listing market and are not marked sell short or laid off at another market. The Commission further notes that eligible, round-lot market and limit orders would be eligible to be automatically matched against other eligible orders at the opening price, without the participation of the Directed Specialist. The Commission believes that the proposal, by providing the proposed matching feature for eligible customer orders, appears to be reasonably designed to increase the automated handling of customer orders at the opening and reduce the risk of specialists trading ahead of customer orders. The Commission notes that the Exchange has represented that the proposal excludes order types involving odd-lots (odd-lot orders, partial round-lot all-or-none orders, and the odd-lot portion of partial round-lot eligible orders) from the proposed matching feature because such orders could otherwise match against

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<sup>10</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. See 15 U.S.C. 78c(f).

<sup>11</sup> 15 U.S.C. 78f(b)(5).

round-lot orders, thereby generating a succession of additional odd-lots and transaction receipts, which would impose an undue transaction cost burden on firms entering round-lot orders. The Commission also notes that the Exchange has represented that all-or-none orders are not eligible for the proposed matching feature when a single contra-side order with sufficient volume is not available in order that, in keeping with the terms of all-or-none orders, such orders may be filled through a single execution. The Commission notes that the Directed Specialist would be obligated to execute all orders that are eligible for an automatic execution guarantee but that are ineligible for the proposed matching feature. The Commission also notes that the Directed Specialist is responsible for providing executions for any imbalance of orders that result from the matching feature. The Commission believes that the proposal appears to be reasonably designed to ensure the execution of orders entitled to an automatic execution guarantee, address the concerns of the Exchange's customers, and promote efficient executions.

#### IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>12</sup> that the proposed rule change (SR-Phlx-2005-14), as amended, be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

Jonathan G. Katz  
Secretary

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<sup>12</sup> 15 U.S.C. 78s(b)(2).

<sup>13</sup> 17 CFR 200.30-3(a)(12).