

the proposed rule change is the requirement under Section 11A(a)(1)(C)<sup>5</sup> which states that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure economically efficient execution of securities transactions, fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets.

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

These enhancements will provide the Exchange the opportunity to compete more effectively for order flow with other marketplaces. Thus, 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*

The Exchange reviewed the proposed rule change with members and organizations representing various constituencies of the Exchange and the responses to the proposed rule changes were positive. The Exchange has not otherwise solicited, and does not intend to solicit, comments on this proposed rule change. The Exchange has not received any written comments from members or other interested parties.

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

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, and, in particular, with the requirements of Section 6(b) of the Act.<sup>6</sup> Eliminating specialist commissions on orders executed within five minutes will improve the cost competitiveness of Exchange executions, which the Exchange believes will inure to the benefit of investors. Additionally, this may assist broker-dealers in fulfilling their best execution duties for their customers. The Commission notes that the proposed rule change also extends provisions of a previously approved pilot program.<sup>7</sup>

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. Approval of the proposal will allow the Exchange to continue the pilot program. Therefore, the Commission believes it is consistent with Section 6(b)(5) and Section 11A(a)(1)(C) of the Act<sup>8</sup> to grant accelerated approval to the proposed rule change.<sup>9</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, N.W., Washington, D.C. 20549-0609. 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 at the Commission's Public Reference Room, located at the above address. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-NYSE-00-13 and should be submitted by May 16, 2000.

#### **V. Conclusion**

*It is Therefore Ordered*, pursuant to Section 19(b)(2) of the Act,<sup>10</sup> that the proposed rule change (SR-NYSE-00-13) extending the pilot program for amendments to Exchange Rule 123B until April 26, 2000 is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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#### **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-42700; File No. SR-Phlx-99-39]

#### **Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Approving Proposed Rule Change Regarding Specialist Enhanced Participation**

April 18, 2000.

#### **I. Introduction**

On October 4, 1999, the Philadelphia Stock Exchange, Inc. ("Exchange" or "Phlx") submitted to 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 seeking to amend Exchange Rule 1014, "Obligations and Restrictions Applicable to Specialists and Registered Options Traders," and its corollary Option Floor Procedure Advice B-6 to revise the enhanced participation available to Exchange specialists. The proposal was amended on November 4, 1999.<sup>3</sup> Notice of the proposed rule change and Amendment No. 1 appeared in the **Federal Register** on November 30, 1999.<sup>4</sup> The Commission received no comments on the proposal. This order approves the proposed rule change, as amended.

#### **II. Description of the Proposal**

On August 26, 1994, the Commission approved the Exchange's proposal to adopt an enhanced participation for Exchange specialists in equity options.<sup>5</sup> The enhancement, or "enhanced parity split," provides Exchange specialists with a greater participation in parity trades than the specialists would otherwise be entitled to receive.

On November 30, 1994, the Commission approved the Exchange's proposal to make the enhanced parity split available to index option specialists.<sup>6</sup> The enhanced parity split was later revised with respect to

<sup>1</sup> 15 U.S.C. 78s(b)(1).

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

<sup>3</sup> In Amendment No. 1, the Exchange made technical changes to the proposal. See Letter from Nandita Yagnik, Phlx, to Richard Strasser, Assistant Director, Division of Market Regulation, Commission, dated November 3, 1999 ("Amendment No. 1").

<sup>4</sup> See Securities Exchange Act Release No. 42161 (November 19, 1999), 64 FR 66958.

<sup>5</sup> See Securities Exchange Act Release No. 34606 (August 26, 1994), 59 FR 45741 (September 2, 1994). Initially, the enhanced parity split was approved as a one year pilot expiring August 26, 1995.

<sup>6</sup> See Securities Exchange Act Release No. 35028 (November 30, 1994), 59 FR 63151 (December 7, 1994).

<sup>5</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>6</sup> 15 U.S.C. 78f(b).

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

<sup>8</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>9</sup> 15 U.S.C. 78f(b)(5) and 78s(b)(2).

<sup>10</sup> 15 U.S.C. 78s(b)(2).

<sup>11</sup> 17 CFR 200.30-3(a)(12).

situations where less than three controlled accounts are on parity with a specialist.<sup>7</sup> The enhanced parity split was renewed unaltered and on a continuing pilot basis on three subsequent occasions.<sup>8</sup> Thereafter, the enhanced parity split was extended until December 31, 1998, and revised so that it would apply to: (1) All index options; (2) 50% of each specialist's equity options; and (3) all new options allocated to a specialist during the year. In addition, specialists were permitted to revise the list of eligible equity options on a quarterly basis, instead of annually.<sup>9</sup> Finally, in July 1999, the enhanced parity split was permanently approved.<sup>10</sup>

The enhanced parity split works as follows: when an equity or index option specialist is on parity with one controlled account<sup>11</sup> and an order for more than five contracts comes into the crowd, the specialist will receive 60% of the contracts and the controlled account will receive 40%. When the specialist is on parity with two controlled accounts and the order is for more than five contracts, the specialist will receive 40% of the contracts and each controlled account will receive 30%. When the specialist is on parity with three or more controlled accounts and the order is for more than five contracts, the specialist will be counted as two crowd participants when allocating the contracts. In any of these situations, if a customer order is on parity, the customer will not be disadvantaged by receiving a lesser allotment than any other crowd participant, including the specialist.

<sup>7</sup> See Securities Exchange Act Release No. 35429 (March 1, 1995), 60 FR 12802 (March 8, 1995).

<sup>8</sup> See Securities Exchange Act Release No. 36122 (August 18, 1995), 60 FR 44530 (August 28, 1995); 37254 (August 5, 1996), 61 FR 42080 (August 13, 1996); and 38924 (August 11, 1997), 62 FR 44160 (August 19, 1997).

<sup>9</sup> See Securities Exchange Act Release No. 39401 (December 4, 1997), 62 FR 65300 (December 11, 1997).

<sup>10</sup> See Securities Exchange Act Release No. 41588 (July 1, 1999), 64 FR 37185 (July 9, 1999). The Exchange also received approval to give specialists an enhanced parity split when they develop and trade a new product ("New Products Split"). Under the New Products Split, when the specialist is on parity with three or more controlled accounts, the specialist receives 40% of the contracts and the controlled accounts receive the remaining 60%. When the specialist is on parity with less than three controlled accounts in the crowd, the specialist receives 60% of the contracts and the controlled accounts receive 40%. In either of these situations, if a customer is on parity, the customer may not receive a lesser allotment than any other crowd participant including the specialist. *Id.*

<sup>11</sup> A controlled account is defined as "any account controlled by or under common control with a member broker-dealer." Customer accounts, which include discretionary accounts, are defined as all accounts other than controlled accounts. See Exchange Rule 1014(g)(i).

Thus, a customer on parity is assured a minimum participation that is equal to the participation of the specialist.<sup>12</sup>

The Exchange now proposes to revise the manner in which the enhanced parity split operates only in those cases where the specialist is on parity with three or more controlled accounts and the order is for more than five contracts. Under the proposal, the specialist will receive 30% of the contracts instead of being counted as two crowd participants in determining the number of contracts the specialist is entitled to receive.

### III. Discussion

For the reasons discussed below, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations under the Act applicable to a national securities exchange. In particular, the Commission believes the proposed rule change is consistent with the section 6(b)(5)<sup>13</sup> requirements that the rules of an exchange be designed to promote just and equitable principles of trade, prevent fraudulent and manipulative acts and practices, and protect investors and the public interest.<sup>14</sup> The Commission also finds that the proposal may serve to remove impediments to and perfect the mechanism of a free and open market by helping the Exchange to attract and retain specialist units.

When an equity or index option specialist is on parity with three or more controlled accounts and the order is for more than five contracts, the proposal gives the specialist 30% of the contracts, rather than counting the specialist as two crowd participants. The proposal will significantly increase the specialist's enhanced participation when the specialist is on parity with five or more controlled accounts. Under the proposal, however, when the specialist is on parity with three or four controlled accounts, the specialist's enhanced participation will be reduced.<sup>15</sup> The Exchange recognizes

<sup>12</sup> The application of this enhanced parity split is mandatory. Therefore, with respect to any equity or index option transaction that implicates the enhanced parity split, the specialist is required to accept the preferential allocation and may not decline the enhancement. If an equity or index option trade is on parity, but not subject to the enhanced parity split (*i.e.*, the order is for five or less contracts), the Exchange specialist is required to allocate the contracts according to the Exchange's priority and parity rules. See Exchange Rule 119, "Precedence of Highest Bid," and Exchange Rule 120, "Precedence of Offers at Same Price."

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

<sup>14</sup> In approving this proposed rule change, the Commission has considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>15</sup> For example, under the current enhanced participation if there is an initiating order of fifty

that the proposal will reduce the number of contracts that a specialist will receive when the specialist is on parity with three or four controlled accounts.<sup>16</sup> The Exchange, however, believes that the proposal will provide a more equitable treatment to all specialists such that specialists of both small and large crowds will receive a significant enhanced participation when there are five or more controlled accounts on parity.<sup>17</sup>

The Commission recognizes that the purpose of the enhanced parity split is to encourage specialists to make deep and liquid markets to attract order flow to the Exchange. The Commission has previously noted that specialists have responsibilities and costs that crowd participants do not share, such as the staff costs associated with the requirement to continually update and disseminate quotes.<sup>18</sup> As a result, the Commission believes it is reasonable for the Exchange to grant certain advantages to specialists, such as the enhanced parity split, to attract and retain well capitalized specialists at the Exchange. As long as these advantages do not unreasonably restrain competition and do not harm investors, the Commission believes that the granting of such benefits to specialists, in general, is within the business judgment of the Exchange. In this regard, the Commission believes that it is reasonable for the Exchange to revise the enhanced parity split as proposed.

The Commission believes that the proposal should provide reasonable benefits to specialists, given their heightened responsibilities and costs. The Commission believes that the approval of the proposal is consistent with the Act because the newly revised enhanced parity split should not unreasonably restrain competition and should not result in harm to investors. The Commission notes that customer orders on parity will continue to be assured a minimum participation equal to any other crowd participant, including the specialist.

### IV. Conclusion

It Is Therefore Ordered, pursuant to section 19(b)(2) of the Act,<sup>19</sup> that the

contracts, and three controlled accounts are on parity, the Specialist will receive twenty contracts and the controlled accounts will each receive ten contracts. In contrast, under the proposal the specialist will only receive fifteen contracts.

<sup>16</sup> See Amendment No. 1, *supra* note 3.

<sup>17</sup> *Id.*

<sup>18</sup> See, e.g., Security Exchange Act Release No. 35177 (December 29, 1994), 60 FR 2419 (January 9, 1995).

<sup>19</sup> 15 U.S.C. 78S(B)(2).

proposed rule change (SR-Phlx-99-39), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>20</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42699; File No. SR-Phlx-99-04]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to Enhanced Specialist Participation in Wheel Trades

April 18, 2000.

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 June 14, 1999, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange"), filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Phlx. The proposed rule change was filed by the Exchange as a "non-controversial" rule change under Rule 19b-4(f)(6)<sup>3</sup> under the Act. 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 proposal amends Options Floor Procedure Advise F-24, AUTO-X Contra-Party Participation (The Wheel) ("Advise F-24"), as it relates to Enhanced Specialist Participation in Wheel trades. Specifically, the proposal modifies paragraph (e) to state that where the Enhanced Specialist Participation of Rule 1014(g)(ii) applies, the specialist shall receive an enhanced participation "substantially equivalent to twice the number of contracts as other crowd participants," rather than "twice the contracts," as the text of Advise F-24 previously stated.

The proposal retains the provision that the Enhanced Specialist Participation on the Wheel requires the

unanimous consent of Wheel participants, but adds the requirement that it be approved by the Options Committee Chairman or his designee.

In addition, the proposal amends paragraph (e) to clarify that the Wheel will rotate in increments depending upon the size of the AUTO-X guarantee, not the size of each individual AUTO-X order.<sup>4</sup>

#### 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 includes statements concerning the purpose of and basis for the proposed rule change and discussed any comment 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 Section A, B, and C below, of the most significant aspects of such statement.

##### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

The Wheel is an automated mechanism for assigning trade participation among specialists and Registered Options Traders ("ROTs") on a rotating basis, as contra-side participants to AUTO-X orders. AUTO-X is the automatic execution feature of the Exchange's Automated Options Market ("AUTOM") system,<sup>5</sup> which provides customers with automatic execution of eligible option orders at displayed markets.

The purpose of the Wheel is to increase the efficiency of order execution through AUTO-X by including floor traders in the automated assignment of contra-parties to incoming AUTO-X orders. Thus, the Wheel is intended to make AUTO-X more efficient, as contra-side participation is assigned automatically, and no longer entered manually. The Exchange's detailed Wheel provisions appear as Advise F-24.<sup>6</sup>

The Enhanced Specialist Participation is a program whereby an equity or index option specialist receives an "enhanced" or additional "split," meaning a higher participation in the

execution of an order.<sup>7</sup> The enhanced parity split applies to: (i) All index options; (ii) all new option classes allocated to a specialist during the year; and (iii) 50% of a specialist's equity option issues, which issues are designated by the specialist and approved by the Exchange's Allocation, Evaluation, and Securities Committee. The program also permits specialists to revise the list of eligible equity options (*i.e.*, the designated equity options for which the specialist is entitled to receive the enhanced parity split) on a quarterly basis. Pursuant to Rule 1014(g)(ii), the enhanced split applies in those situations where an equity or index option specialist is on parity with one or more controlled accounts<sup>8</sup> for orders involving more than five contracts.

As of the date this proposed change to the Wheel allocation was filed, the enhanced specialist split was defined by Rule 1014(g)(ii) as follows: when the specialist was on parity with one controlled account, the specialist received 60% of the contracts and the controlled account received the remaining 40%. When the specialist was on parity with two controlled accounts, the specialist received 40% of the contracts and each controlled account received 30%; and when the specialist was on parity with three or more controlled accounts, the specialist was counted as two crowd participants for purposes of allocating the contracts. In all of these situations, if a customer is on parity, the customer could not receive a lesser allotment than any other crowd participant, including the specialist.

In August of 1998, the Phlx amended Advise F-24 to allow specialists to receive twice the number of contracts as other Wheel participants to achieve an enhanced participation consistent with the provisions of Phlx Rule 1014(g)(ii). The enhanced participation was implemented in the form of an

<sup>7</sup> The program was initially approved in 1994 as a one year pilot. See Securities Exchange Act Release No. 34606 (August 26, 1994), 59 FR 45741 (September 2, 1994). It has subsequently been extended and revised. See Securities Exchange Act Release Nos. 35028 (November 30, 1994), 59 FR 63151 (December 7, 1994); 35429 (March 1, 1995), 60 FR 12802 (March 8, 1995); 36122 (August 18, 1995), 60 FR 44530 (August 28, 1995); 37254 (August 5, 1996), 61 FR 42080 (August 13, 1996); 38924 (August 11, 1997), 62 FR 44160 (August 19, 1997); 39401 (December 4, 1997), 62 FR 65300 (December 11, 1997); and 40876 (December 31, 1998), 64 FR 1849 (January 12, 1999). The Commission granted the pilot permanent approval in July 1999. See Securities Exchange Act Release No. 41588 (July 1, 1999), 64 FR 37185 (July 9, 1999).

<sup>8</sup> Pursuant to Rule 1014(g)(i), a controlled account includes any account controlled by or under common control with a member broker-dealer.

<sup>20</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

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

<sup>3</sup> 17 CFR 240.19b-4(f)(6).

<sup>4</sup> See Securities Exchange Act Release No. 37977 (November 26, 1996), 61 FR 63889 (December 2, 1996.)

<sup>5</sup> AUTOM is an electronic order routing and delivery system for option orders.

<sup>6</sup> See Securities Exchange Act Release No. 35033 (November 30, 1994), 59 FR 63152 (December 7, 1994).