

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43127; File No. SR-BSE-99-1]

### **Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to an Amendment to the Proposed Rule Change by the Boston Stock Exchange, Inc. To Allow Specialists Remote Access to the BEACON System**

August 8, 2000.

#### **I. Introduction**

On March 26, 1999, the Boston Stock Exchange, Inc. ("BSE" 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 implement a program for remote specialist trading.

The Commission published notice of the proposed rule change in the **Federal Register** on June 10, 1999.<sup>3</sup> The Commission did not receive any comment letters on the proposal. The Exchange amended the proposed rule change on June 26, 2000.<sup>4</sup> For the reasons discussed below, the Commission is approving the proposed rule change and is granting accelerated approval to the amendment to the proposed rule change.

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

The Exchange proposes to permit BSE specialists to conduct regular trading activities off the BSE's trading floor using the BEACON trading system.<sup>5</sup> Currently, specialists can access the BEACON system only from the Exchange's physical trading floor, and all market making occurs on that floor. Under the program, specialists will have the ability to access the BEACON

system from remote locations using terminals and related equipment. Like floor specialists, remote specialists will receive orders, commitments over the Intermarket Trading System ("ITS"), and administrative messages through the BEACON system.

The Exchange states that it seeks to give BSE specialist firms the option to operate remotely under existing Exchange systems and rules, while retaining the ability to permit specialists to trade on the physical trading floor. The Exchange notes that it views the remote specialist proposal as being "a natural first step in the progression from a manual open outcry system of trading to an automated electronic trading system." According to the Exchange, all executions occurring within BEACON, whether conducted on the floor or electronically from remote locations, will be considered to be executions occurring on the Exchange.

To authorize the remote specialist program, the Exchange proposes to add new Section 9, "BEACON Remote," to Chapter XXXIII of the Exchange's rules, which governs the BEACON system. The introductory part of Section 9 generally explains that the Exchange will provide terminals linked to the BEACON system for specialist trading at remote member firm locations with the same functions that are available to on-floor specialists, and that all orders directed to remote specialists will be sent through the BEACON system. The introductory part of Section 9 further explains that the Exchange will not have remote floor brokerage services, and the BEACON system will route floor broker orders under existing rules.<sup>6</sup> The remainder of proposed Section 9 describes how remote specialists will operate, discusses the information barrier requirements that remote specialists must follow, and sets forth the way that the Exchange will select and surveil remote specialists as well as other minimum criteria that remote specialists must satisfy.

#### *A. Rights, Duties and Operation of Remote Specialists*

##### **1. Application of BSE rules to remote specialists**

The Exchange will apply all of its membership, net capital, equity, examination, specialist performance evaluation, competing specialist, stock allocation, and trading rules and policies to remote specialists in the same way that the Exchange applies

those rules and policies to on-floor specialists.<sup>7</sup> For example, the Exchange will require remote specialists—like other specialists—to make two-sided markets in specialty securities, execute customer orders they have accepted, and act as odd-lot dealers. The Exchange will also require remote specialists to maintain records as required by Exchange rules.

Proposed Section 9(h) provides that each remote specialist must adopt a written confidentiality policy regarding the location of equipment and access to information, terminals and equipment, that must be filed with and approved by the Exchange prior to the commencement of remote trading.<sup>8</sup> This policy must conform to all requirements set forth in the rules of the Exchange, including but not limited to provisions requiring confidentiality of the specialist's book, governing information barriers when specialists are affiliated with approved persons, and governing the obligation to establish procedures to prevent the misuse of inside information. Firms must apply reasonable principles to limit remote specialist access to the firm's other trading desks, including verbal or visible communications (whether or not intentional).<sup>9</sup> Moreover, proposed Section 9(i) specifies that access to the remote specialist's designated area must be restricted to the specialist, backup specialists, clerks, designated management of the specialist firm, and Exchange-authorized personnel.<sup>10</sup>

Under the proposal, participating firms cannot remotely trade securities that the firm trades on the Exchange's floor, unless the Exchange's Market Performance Committee provides otherwise. Proposed Section 9(d) further states that a specialist firm may not trade individual securities in more than one location. Finally, no specialist account may remotely trade more than 200 specialty stocks.

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

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

<sup>3</sup> Securities Exchange Act Release No. 41471 (June 2, 1999), 64 FR 31332 (June 10, 1999) ("Notice").

<sup>4</sup> See Letter from George Mann, Senior Vice President and General Counsel, BSE, to Sharon Lawson, Senior Special Counsel, Division of Market Regulation ("Division"), Commission, dated June 23, 2000 ("Amendment No. 1"). Amendment No. 1 requested that the Commission approve the program on a permanent basis, rather than as a one-year pilot. Amendment No. 1 also changed the proposed rule language to more clearly state the information barrier obligations applicable to remote specialists and to clarify other requirements and standards, as is discussed below.

<sup>5</sup> The BEACON system is the Exchange's securities communication, order-routing and execution system. See generally BSE Rules, Chapter XXXIII.

<sup>6</sup> As proposed in the Notice, the introductory part of Section 9 also referred to the remote specialist program being a 12 month pilot. Amendment No. 1 removed all references to a pilot program.

<sup>7</sup> Proposed Section 9(a) states that all Exchange rules and policies will apply to remote specialists except as specifically excluded or amended. Moreover, proposed Section 9(g) states that all BSE rules pertaining to the Exchange's trading floor apply to remote trading, and identifies several of those rules. Section 9(i), however, states that floor policies regarding dress codes and smoking shall not apply to remote specialists.

<sup>8</sup> Subsequent to the Notice, the sections were renumbered.

<sup>9</sup> Amendment No. 1 noted that these confidentiality provisions must be consistent with the Exchange's rules, added the specific references to Chapter XV, Section 6, and Chapter II, Sections 36 and 37. Amendment No. 1 further stated that the firm was obligated to apply reasonable principles to restrict access.

<sup>10</sup> Language proposing to exempt remote specialists from Exchange rules regarding visitors was removed in Amendment No. 1.

## 2. Remote specialist access to BSE systems

Remote specialist terminals will be linked to the BEACON trading system using dedicated lines and connected via the same wide area network that the Exchange currently uses to link the physical trading floor to the Exchange's data center. These terminals will provide the same functionality that is available to on-floor specialists. Like on-floor specialists, remote specialists will have access to the Intermarket Trading System.

Remote specialists will be routed orders, ITS commitments, and administrative messages from the Exchange's data center through BEACON. Thus, any type of order entry that has not been approved and is not already in use in accordance with the rules of the Exchange will be prohibited, including verbal orders placed directly with the specialist. Remote specialists will be subject to the same limit order display requirements that apply to other BSE specialists.<sup>11</sup>

Floor broker orders will also be routed to remote specialists under the same criteria by which they are routed to on-floor specialists.<sup>12</sup> Members will not be able to use the BEACON remote specialists program to conduct floor brokerage services.

## 3. Remote specialist communication with the Exchange

All Exchange correspondence, memoranda, bulletins, and other publications will be sent to remote specialists via electronic mail through BEACON and via U.S. mail or overnight delivery. Remote specialists will have access to the physical trading floor through stentofon<sup>13</sup> or a similar speakderphone, as well as through dedicated telephone lines. Any regulatory requirements requiring the

<sup>11</sup> Like other BSE specialists, remote specialists will maintain customer limit orders on the BEACON system, where they will have the opportunity to interact with other orders that arrive on the Exchange. The Exchange will conduct surveillance of limit order display practices by remote specialists to ensure that those practices are consistent with all applicable requirements, including the Commission's limit order display rule, 17 CFR 240.11Ac1-4. Conversation between George Mann, BSE, and Joshua Kans, Division, Commission, August 7, 2000.

<sup>12</sup> For example, the exchange's order routing system may route floor brokers to a remote specialists if that remote specialist is quoting with time priority on the Exchange. Conversation between George Mann, BSE, John Boese, Assistant Vice President, BSE, and Joshua Kans, Division, Commission, June 30, 2000.

Proposed Section 9(i) provides that serving of BEACON terminals and related equipment will be by Exchange authorized and trained personnel only.

<sup>13</sup> BSE's stentofon system provides electronic voice communications among BSE members.

involvement of floor officials, such as trading halts and other trading practices, will be coordinated by Exchange personnel with the remote specialist through the dedicated telephone lines.<sup>14</sup> Finally, any arbitration or disciplinary action arising out of remote trading activity will be held at the Exchange's offices in Boston.

## 4. Surveillance

The Exchange states that it will conduct surveillance and compliance monitoring of remote specialist trading activity through the BEAM on-line surveillance system<sup>15</sup> as it does today with on-floor specialists. Remote specialists will be required to use layoff systems that are electronically linked to BEACON to help ensure that a surveillance audit trail is created by a drop copy report.<sup>16</sup>

Moreover, the Exchange's examination program will include the remote specialist operations of all firms. Every firm must submit supervisory procedures relating to remote specialist operations and to identify all individuals who will have access to remote specialist operations, including all supervisory personnel.<sup>17</sup>

## B. Selection of Remote Specialists

Proposed Section 9(c) provides that any eligible firm may apply to the Market Performance Committee to participate in the program. Applicant specialists must meet the current minimum requirements for specialists set forth in Chapter XV of the

<sup>14</sup> Amendment No. 1 clarified that Exchange personnel will coordinate floor official involvement with remote specialists.

The Exchange explains that there are only limited situations in which a specialist would consult with a floor official—trading halts, issues involving ITS, and executions at an inferior price. The Exchange further explains that the Exchange keeps a record of any situation that requires a floor official ruling, and that the Exchange will continue to follow that procedure for remote specialists.

<sup>15</sup> The BEAM system provides the Exchange with real-time capabilities to monitor specialist trading activity within the BEACON systems.

<sup>16</sup> The drop copy system generates a report of all executions of orders sent to other market centers for purposes of specialist position updating, clearance and settlement, and audit trail. BSE members may send orders to the New York Stock Exchange through the Designated Order Turnaround ("DOT") system and to the American Stock Exchange through the Post Execution Reporting ("PER" system).

<sup>17</sup> The Exchange conducts a full examination of the books and records of those member firms assigned to it as the Designated Examining Authority ("DEA"). In addition, the Exchange conducts a more limited examination of the books and records of all non-DEA member firms with specialist operations on the floor (limited to books and records related to specialist operations only). This review will be expanded to include the examination of the books and records of all firms with remote specialist operations.

Exchange's rules, including requirements related to their background,<sup>18</sup> experience, staffing, training procedures, adequacy of proposed confidentiality policy, adequacy of contingency plans for communication or technology failures, adequacy of offsite facilities, and performance standards, as well as the minimum margin, capital, and equity requirements set forth in Chapters VIII and XXII of the Exchange's rules.<sup>19</sup>

## C. Implementation

The Exchange states that, upon the Commission's approval of the proposed rule change, the Exchange will allow time to install terminals and make other arrangements before beginning the program. The Exchange expects to implement the program later this year.<sup>20</sup>

Proposed Section 9(b) and the Commentary to Rule 9 state that during the preliminary stages of the remote specialist program, the Exchange will only permit member firms with existing Exchange specialist operations to participate because the Exchange has already evaluated current floor member firms as to their familiarity with the Exchange's rules, capital, equity and margin requirements, experience, staffing and training procedures, and performance standards. As soon as practicable after the rollout of the program, the Exchange will consider applications from other firms, based on the other criteria identified in Section 9(c), including adequate off-site facilities to ensure compliance with the Exchange's rules, and adequate capital to manage the risks associated with the program. For every applicant who is not an existing on-floor specialist, the Exchange will require a two week on-floor training period.

<sup>18</sup> The Commission notes that an applicant's background will include, among other things, any disciplinary history.

<sup>19</sup> Amendment No. 1 added those specific requirements to the text of the rule. Amendment No. 1 also clarified that eligibility requirements set forth in Section 9(c) do not differ from any of the requirements for an on-floor specialist, other than additional criteria needed for off-site operational capability. Amendment No. 1 also stated that any firm may apply for membership on the Exchange but must meet the various eligibility requirements, and that applications for a seat, as well as to become a specialist firm, can take place at the same time as applications to be a remote specialist.

When the Committee evaluates a firm's request to change the location where a stock is traded, the Committee will consider the requirements set forth in Section 9(c).

<sup>20</sup> Conversation between John Boese, BSE, and Joshua Kans, Division, Commission, June 29, 2000.

### III. Discussion

#### A. General Findings

The Commission finds that the proposed rule change is consistent with Section 6(b)(5) and 11A of the Act.<sup>21</sup> Section 6(b)(5) requires, among other things, that the rules of an exchange be designed 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.<sup>22</sup> Section 11A of the Act promotes, among other things, the development of a national market system for securities to assure economically efficient execution of securities transactions and fair competition among brokers and dealers, among exchange markets and markets other than exchange markets.<sup>23</sup>

After having carefully reviewed the proposal, the Commission finds that it will promote efficiency by potentially reducing the costs associated with transactions on the Exchange, and that it will promote liquidity and competition on the Exchange by facilitating the ability of specialists to make markets either on or off of the BSE's physical floor. In particular, by allowing BSE specialists to conduct their activities off of the Exchange's physical trading floor, while retaining the availability of on-floor market making, the proposal will permit BSE specialists to choose the most efficient and cost-effective way of conducting their business. At the same time, remote specialists will have full access to the information and functions available on the BEACON trading system, and the BEACON system will maintain and display limit orders represented by remote specialists consistent with the practices applicable to other BSE specialists. Accordingly, the proposal uses technology in a manner that should promote competition in the securities markets, consistent with the congressional mandate set forth in Section 11A of the Act.

The remote specialist proposal is consistent with other competitive developments in securities trading. For example, the Cincinnati Stock Exchange has traded stocks without a floor for

several years. The Nasdaq Stock Market has never had a physical trading floor. In 1998, the Commission promulgated Regulation ATS because it recognized that technology had moved beyond earlier concepts of what constitutes an "exchange."<sup>24</sup> To facilitate competition among trading systems, the Regulation ATS, among other things, enhanced the ability of existing stock exchanges to operate alternative trading system pilot programs. The BSE's remote specialist proposal is yet another initiative that uses technology to promote competition among market centers.

At the same time, the BSE's proposal differs from those initiatives in that BSE will continue to maintain a physical trading floor while also allowing specialists to trade from off-floor locations. That raises special and distinct issues related to the BSE's responsibilities to conduct market surveillance, enforce members' compliance with BSE's rules and the Act, and coordinate regulatory actions both on and off the floor. The Commission is satisfied that the BSE's proposed rules provide an adequate framework to address those issues.

#### B. Remote Specialist Confidentiality Safeguards

As noted above, all firms that apply to serve as BSE remote specialists must submit, for the Exchange's prior approval, a written confidentiality policy regarding the location of equipment and the access to information, terminals, and equipment. Among other things, the policy must conform with specific standards applicable to all specialists, including compliance with BSE rules that govern the conditions under which a broker-dealer may conduct specialist operations in conjunction with a diversified broker-dealer's other operations.<sup>25</sup> Those rules permit diversified broker-dealers with non-

floor operations to also act as specialists on the BSE floor, subject to certain conditions. The Exchange is also implementing specific confidentiality rules relevant to remote specialists to address the regulatory concerns associated with having a firm's specialist facilities located in proximity to the firm's other trading desks. For example, proposed Section 9(i) will restrict access to the remote specialist's trading area to certain designated persons. Proposed Section 9(h) will require that a firm apply reasonable procedures to limit access by non-specialists to remote specialist facilities and information, and to limit remote specialist access to other proprietary trading venues. Those requirements are intended, in part, to help prevent the improper flow of information back and forth between remote specialists and a firm's trading desk personnel located in proximity to the specialists.

The BSE's remote specialist rules will implement those standards in part by specifically requiring the Exchange's Market Performance Committee to evaluate, among other factors, the adequacy of the firm's proposed confidentiality policy and offsite facilities when determining whether to approve a firm's application to act as a remote specialist. Indeed, the Exchange states that it will examine each applicant firm's remote site to ensure compliance with those standards, "focusing on policies, procedures and physical barriers which restrict access to the remote specialist in all ways."

The BSE also notes that all orders received by remote specialists must be routed through BEACON, and that the Exchange will prohibit any kind of other entry that has not been approved and is not already in use in accordance with the rules of the Exchange. Among other things, this prohibits verbal orders placed directly with the specialist.

Based on these requirements, and the Exchange's commitment to examine remote specialist locations to ensure adequate compliance with BSE rules, the Commission believes the Exchange has provided an adequate framework for addressing the confidentiality issues associated with allowing specialists to trade from remote locations in proximity to a diversified broker-dealer's other off-floor operations. BSE's requirements also should help to ensure that a member firm's traders will not get a market advantage because of their physical proximity to the specialist trading unit, and vice versa.<sup>26</sup>

<sup>21</sup> In approving this rule, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

<sup>22</sup> 15 U.S.C. 78f(b)(5).

<sup>23</sup> 15 U.S.C. 78k-1.

<sup>24</sup> As discussed below, the Exchange will not be able to commence remote specialist trading until it

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### C. Communications With Remote Specialists

The BSE proposal is also designed to ensure that the Exchange can properly communicate with specialists operating from remote locations. In this regard, the remote specialist locations will be linked to the Exchange through either stentofon or similar device, as well as a dedicated line. Using those links, Exchange personnel will coordinate regulatory rulings requiring floor official approval or involvement, such as trading halts, ITS issues and executions at an inferior price. Any ruling will continue to be recorded in a log maintained by the Surveillance Department. Moreover, when reviewing applications to become a remote specialist, the Exchange's Market Performance Committee must evaluate the adequacy of the firm's contingency plans for communications or technology failures, as well as the adequacy of the off-site facilities generally. The Commission agrees that these rules are reasonable, and that adequate means exist for Exchange personnel to communicate with remote specialists and facilitate transactions in securities consistent with the requirements of Section 6(b)(5) of the Act. The Commission expects that the BSE will carefully monitor such communications to ensure they are done in a timely manner, particularly if the communication involves a regulatory issue.

### D. Implementation

The Commission finds that the Exchange has proposed a reasonable schedule for implementing its remote specialist program. During the preliminary stages of the program, only member firms with existing specialist operations on the Exchange will be eligible to participate in the program. The Exchange explains that this is because the Exchange has already evaluated current floor member firms' familiarity with the Exchange's rules and procedures. As soon as practicable following the rollout of the program, the Exchange will consider other applicants. The Commission finds that this is a reasonable approach to allow the Exchange to implement the program while reducing potential difficulties.

### E. Conclusion

Based on the above, the Commission finds that the BSE proposal satisfies the minimum necessary framework for

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has developed specific procedures, acceptable to the Commission, for the Exchange to evaluate whether a firm has adequately implemented those confidentiality standards.

operating specialist units off of the physical trading floor. Accordingly, the Commission finds that the proposal is consistent with the Section 11A and 6(b)(5) of the Act. By applying general specialist standards to remote specialists, but exempting them from irrelevant rules, the Exchange will promote the fair application of its rules and competitive market making by specialists. The Commission further finds that the Exchange's other proposed remote specialist rules, such as conditions on eligibility for the remote specialist program, are suitable because they will allow the Exchange to implement and evaluate the program while minimizing disruptions to Exchange operations, and because they otherwise appear reasonably geared to promote the fair and efficient implementation of the program.<sup>27</sup>

As noted above, however, although the Exchange's proposal requires that adequate protections against the misuse of information be put into place, the proposed rules do not enunciate the specific standards that are necessary to satisfy that requirement. Accordingly, the Commission is conditioning its approval of the proposed rule change to require that, before the Exchange begins remote specialist trading, the Exchange must develop and put into place specific information barrier policies and surveillance policies that are consistent with the Exchange's existing rules and that are acceptable to the Commission's Office of Compliance Inspections and Examinations.<sup>28</sup>

The Commission finds good cause for approving Amendment No. 1 prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. Amendment No. 1 requested that the Commission approve

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<sup>27</sup> The Commission also notes that while the remote specialist program may have the effect of attracting additional order flow to the BSE, this must occur consistent with best execution principles. Accordingly, broker-dealers choosing where to route orders must assess periodically the quality of competing markets to assure that order flow is directed to markets providing the most advantageous terms for their customers' orders. Thus, a broker-dealer may not simply employ default order routing to a BSE remote specialist without undertaking such an evaluation on an ongoing basis. To reach this conclusion, the broker-dealer must rigorously and regularly examine the executions likely to be obtained for customer orders in the different markets trading the security, in addition to any other relevant considerations in routing customer orders.

<sup>28</sup> Before the BSE allows remote specialist trading to begin at an off-site facility, the Exchange must fully investigate that facility, and ensure that trading at the facility will be subject to information barrier and surveillance policies that address the particular circumstances of the facility.

The Commission notes that the participants to the ITS plan are proposing amendments to the plan to accommodate remote specialists.

the program on a permanent basis, rather than as a one-year pilot program. Permanent approval of the program is appropriate because it will permit the Exchange to implement the program in a manner that will expedite the ability of firms to take advantage of the program, subject to the Exchange exercising its responsibility for ensuring that remote specialist firms follow all applicable rules. Amendment No. 1 also modified several of the proposed remote specialist rules to specify the nature of the information barrier procedures that remote specialist firms must follow. In addition, Amendment No. 1 identified the factors that will govern applications involving remote specialists, and otherwise clarified the rules and practices involving remote specialists. Those modifications did not change the underlying nature of the original proposal that was noticed for comment, and for which no comments were received. Based on the above, the Commission believes that good cause exists, consistent with Section 6(b)(5) and 19(b)(2)<sup>29</sup> of the Act, to accelerate approval of Amendment No. 1.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether it 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 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 Exchange. All submissions should refer to File No. SR-BSE-99-1 and should be submitted by September 5, 2000.

### V. Conclusion

*It is Therefore Ordered*, pursuant to Section 19(b)(2) of the Act, that the proposed rule change SR-BSE-99-1, including Amendment No. 1, is approved.

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<sup>29</sup> 15 U.S.C. 78s(b)(2).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>30</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

[FR Doc. 00-20512 Filed 8-11-00; 8:45 am]

BILLING CODE 8010-01-M

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43126; File No. SR-Phlx-00-34]

### **Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 by the Philadelphia Stock Exchange, Inc. To Require Immediate Display of Customer Limit Orders by Specialists**

Date: August 7, 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 April 11, 2000, 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 Exchange. On July 5, 2000, the Phlx filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change and Amendment No. 1 from interested persons.

#### **I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

The Phlx, pursuant to Rule 19b-4 of the Act, proposes to amend Phlx Rule 1020, and Options Floor Procedure Advice ("OFPA") A-1, "Responsibility of Displaying Best Bids and Offers," to require the immediate display of customer limit orders by specialists. As amended, the Phlx proposal would require specialists to immediately display customer limit orders as soon as practicable, and under normal market conditions, no later than 30 seconds

after receipt. Additionally, the proposed rule change would increase the amount of the fines imposed for violations of OFPA A-1. The Phlx proposes to aggregate an individual's total number of violations for a period of three years. The Exchange is proposing to amend its minor rule violation enforcement and reporting plan ("minor rule plan") accordingly.<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 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 amend Exchange Rule 1020 and OFPA A-1 to require immediate display of customer limit orders by specialists. Currently, OFPA A-1 ("Responsibility of Displaying Best Bids and Offers) and Phlx Rule 1020 ("Registration and Functions of Options Specialists") require that specialists use due diligence to display the best bid and offer in an option series. The proposed rule change, as amended, would require specialists to immediately display customer orders that better the market. The proposal states that under normal market conditions, a specialist must immediately display customer limit orders (*i.e.*, as soon as practicable and no later than 30 seconds after receipt). The proposal replaces the current "due diligence" standard with an immediate display requirement.

Currently, the fine schedule for violations of OFPA A-1 is as follows: first offense, \$50; second offense, \$100; third offense, \$250; fourth offense and

more, sanction discretionary with the Exchange's Business Conduct Committee. The Phlx implements this fine schedule on a one-year running basis.

The proposed rule change would increase the amount of the fines as follows: First offense, \$250; second offense, \$500 third offense, \$1,000; fourth offense and more, sanction discretionary with the Exchange's Business Conduct Committee. The proposed fine schedule would be implemented on a three-year running basis during which an individual's total violations will be counted.<sup>5</sup>

The Exchange believes that the proposal to require specialists to immediately display customer limit orders and to increase the fine schedule for a specialist's failure to comply reflects the Exchange's attempt to make more current, accurate market information available to the public and to make a specialist's failure to comply a more severe violation of the Exchange's rules.

###### **2. Statutory Basis**

The Exchange believes that the proposed rule change is consistent with the requirements of Section 6 of the Act,<sup>6</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>7</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in facilitating transactions in securities, and remove impediments to and perfect the mechanism of a free and open market and a national market system.

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

The Exchange believes that the proposed rule change will not 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 has neither solicited nor received written comments on the proposed rule change.

#### **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**

<sup>30</sup> See 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> Letter from Richard S. Rudolph, Counsel, Phlx, to Jennifer Colihan, Attorney, SEC, dated July 3, 2000 ("Amendment No. 1"). In Amendment No. 1, the Phlx clarified that immediate display of customer limit orders meant that customer limit orders would be displayed as soon as practicable, and under normal market conditions, no later than 30 seconds after receipt. Amendment No. 1 also changed the proposed rule language for the implementation of the fine schedule from a "three year running calendar basis" to a "three year running basis."

<sup>4</sup> The Phlx's minor rule plan, codified in Phlx Rule 970, contains floor procedure advices with accompanying fine schedules. Rule 19d-1(c)(2) under the Act authorizes national securities exchanges to adopt minor rule violation plans for summary discipline and abbreviated reporting; Rule 19d-1(c)(1) requires prompt filing with the Commission of any final disciplinary action. However, fines for minor rule violations not exceeding \$2,500 are deemed not final, thereby permitting periodic, as opposed to immediate, reporting.

<sup>5</sup> See Amendment No. 1, *supra* note 3.

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

<sup>7</sup> 15 U.S.C. 78f(b)(5)