

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43254; File No. SR-Phlx-00-62]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change of the Philadelphia Stock Exchange, Inc. Relating to Mandatory Auto-Quote Settings To Update Quotations Based on a Certain Minimum Movement in the Underlying Security

September 6, 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 August 1, 2000, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Phlx. 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 proposes to amend Commentary .01 to Exchange Rule 1080, "Philadelphia Stock Exchange Automated Options Market (AUTOM) and Automatic Execution System (AUTO-X)," to allow the Chairman of the Exchange's Board of Governors to mandate that, for quote capacity management purposes, the Exchange's Auto-Quote system ("Auto-quote")<sup>3</sup> be set to update options quotations based on a certain minimum movement in the underlying security.

The proposed rule would state that if options trading systems throttle quotations for at least three minutes, the Chairman of the Exchange's Board of Governors or his designee may, for capacity management purposes, mandate that Auto-Quote be set to update quotations based on a certain minimum movement in the underlying security.<sup>4</sup> Such minimum setting may

continue for a period of 15 minutes, and may be continued every 15 thereafter, provided that the Exchange's options trading systems are throttling quotations at the end of such 15-minute period.

The text of the proposed rule follows. Additions to the rule are in italics.

\* \* \* \* \*

#### Rule 1080. Philadelphia Stock Exchange Automated Options Market (AUTOM) and Automatic Execution System (AUTO-X)

(a)-(h) No change.

Commentary:

.01 Automatic Quotation (Auto-Quote) is the Exchange's electronic options pricing system, which enables specialists to automatically monitor and instantly update quotations. *If options trading systems throttle quotations for at least three minutes, the Chairman of the Board of Governors or is designee may, for capacity management purposes, mandate that the Auto-Quote be set to update quotations based on a certain minimum movement in the underlying security for: (i) all options; (ii) index options only; or (c) certain specified options, taking into account certain factors that may include, but are not limited to, the price of the underlying security, volatility in the underlying security, or whether there has been any trading volume over the last two trading days. Such mandated minimum setting may continue for a period of 15 minutes, and may be continued every 15 minutes thereafter, provided that the Exchange's options trading systems are throttling quotations at the end of each such 15-minute period.*

.02-.03 No change.

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#### 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 self-regulatory organization has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

update quotations in the options based on, for example, a price change of 1/4 in the underlying security, meaning that Auto-Quote would not update quotations on the overlying option until the price of the underlying security increases or decreases by 1/4. The increase in the incremental price change in the underlying security would result in fewer options quotations being disseminated.

#### 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 allow the Exchange's Chairman or his designee to take measures to reduce the volume of outbound options quotations during periods of peak Auto-Quote capacity usage on the Exchange's Options Floor. Currently, Auto-Quote includes three commonly used options pricing algorithms: the Black Scholes Option Pricing Model; the Cox, Ross and Rubenstein Binomial Option Pricing Model; and the Barone, Adesi and Whaley American Option Pricing Model. In addition, a specialist unit may separately employ other pricing models (called specialized quote feed). Each specialist decides which pricing model to use and may change the trading model during the trading day.

Outbound options quotations are forwarded electronically to the Options Price Reporting Authority ("OPRA"), which in turn disseminates them to various vendors of the information. Recently, due to increased overall options volume and significant increases in the number of quotations generated, OPRA has, at times, been unable to disseminate quotation traffic on a timely basis. In order to address the capacity constraints, each exchange has been assigned a specific allotment of bandwidth capacity for messages transmitted to, and received from OPRA. Each exchange must limit the volume of the quotation traffic it transmits to OPRA to its specific capacity allocation.<sup>5</sup>

In order to address its own capacity issues, OPRA has set a timetable for increasing its ability to process message traffic. OPRA has stated that, by September 30, 2000, it expects all options exchanges sending quotation information, as well as the vendors receiving this information from OPRA, to be ready to operate in an enhanced environment utilizing telecommunications lines with substantially greater message traffic capability (from 5,000 to 8,000 messages per second).

The proposed rule is intended to address the Exchange's ability to manage quote traffic while the various solutions to quote capacity issues are being implemented. Currently, one

<sup>5</sup> See Securities Exchange Act Release No. 42779 (May 12, 2000), 65 FR 36180 (May 19, 2000) (pertaining to OPRA temporary capacity allocation plan).

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

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

<sup>3</sup> Auto-Quote is the Exchange's electronic options pricing system that enables specialists to automatically monitor and instantly update quotations, based on incremental changes in the price of the security underlying the option.

<sup>4</sup> For example, Auto-Quote may be set to update options quotations based on a price change of 1/8, meaning that each time the price of the underlying security increases or decreases by that amount, Auto-Quote would update the quotation on the overlying option to reflect such a change. The proposed rule would allow the Chairman or his designee to mandate that the Auto-Quote be set to

longstanding method the Exchange has used to manage quote traffic is "throttling," or capping outbound quote traffic to OPRA. For many years, the Exchange has had in place, within its options trading systems, the ability to internally throttle total outbound message traffic to OPRA by limiting, to a level equal to the Exchange's capacity allocation, the amount of messages sent to OPRA in a given second. This is accomplished by withholding some Auto-Quote generated messages from dissemination each second until the next second. Throttling may result in some quotations being overridden by subsequent quotations. Throttling may, therefore, prevent older quotations-in-waiting from ever being disseminated.

The proposed rule addresses the Exchange's ability to manage the actual number of option quotations being generated by permitting the Chairman or his designee to direct that Auto-Quote be set to update quotations based on a certain minimum movement in the underlying security.

## 2. Statutory Basis

The Phlx believes that the proposed rule change is consistent with Section 6 of the Act<sup>6</sup> in general, and with Section 6(b)(5) of the Act<sup>7</sup> specifically, in that it is designed to perfect the mechanisms of a free and open market and the national market system, and to protect investors and the public interest.

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

The Phlx does not believe that the proposed rule change will 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 Phlx 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 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, NW, Washington, DC 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 Phlx. All submissions should refer to File No. SR-Phlx-00-62 and should be submitted by October 5, 2000.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>8</sup>

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

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43260; File No. SR-Phlx-00-51]

### **Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to the Reporting Structure of the Internal Audit Department**

September 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 August 24, 2000, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in

Items I, II, and III below, which Items have been prepared by the Exchange. 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 Exchange proposes to amend its By-Law Article X, Section 10-9, to state that the Exchange's Internal Audit Department will report to the Audit Committee of the Exchange. The text of the proposed rule change is available at the Office of the Secretary, the Exchange, and at the Commission.

### **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 Exchange 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 Exchange 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

Currently, pursuant to Phlx By-law Article X, Section 10-9(b), the Internal Audit Department reports to both the Audit Committee and the General Counsel of the Exchange. The purpose of the proposed By-Law amendment is to change the reporting structure of the Internal Audit Department so that it reports only to the Audit Committee, a body composed in such a way that facilitates the exercise of independent judgment in oversight matters relating to the Exchange.<sup>3</sup> The proposed rule change should enhance the independence of the Internal Audit Department<sup>4</sup> and is consistent with the

<sup>3</sup> The Audit Committee consists of three members who are public members of the Exchange's Board. Audit Committee members cannot serve in a management capacity with the Exchange or any affiliate, and must be free of any other relationships that would interfere with the exercise of independent judgment. Phlx By-Law Article X, Section 10-9(a).

<sup>4</sup> See, Standard 100 of *Standards for the Professional Practice of Internal Auditing* (The Institute of Internal Auditors, 1998): "Internal auditors should be independent of the activities they audit."

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

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

<sup>8</sup> 17 CFR 200.30-3(a)(12)

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

<sup>2</sup> 17 CFR 240.10b-4.