

the Commission's Public Reference Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of OCC. All submissions should refer to File No. SR-OCC-2001-15 and should be submitted by December 4, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁴

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45031; File No. SR-OCC-2001-14]

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to the Correction of an Erroneous Cross-Reference in Section 5(e) of Article VIII of the By-Laws

November 6, 2001.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹, notice is hereby given that on September 28, 2001, the Options Clearing Corporation ("OCC") 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 primarily by OCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

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

The proposed rule change would amend Article VIII, Section 5(e) of OCC's by-laws to correct an erroneous cross-reference.²

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

In its filing with the Commission, OCC 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. OCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.³

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

In 1999, OCC filed a rule change to merge its stock and non-equity clearing funds into a single clearing fund.⁴ In that filing, OCC inadvertently neglected to change a cross-reference in Section 5(e) of Article VIII of its by-laws. Specifically, the reference to paragraph (c) in Section 4(e)(ii) has been corrected to refer to paragraph (b).

The proposed rule change is consistent with the requirements of Section 17A of the Act because it clarifies the meaning of the referenced by-law by correcting the erroneous cross-reference.

(B) Self-Regulatory Organization's Statement on Burden on Competition

OCC does not believe that the proposed rule change would impose any burden on competition.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others

Written comments were not and are not intended to be solicited with respect to the proposed rule change, and none have been received.

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)(i) of the Act⁵ and Rule 19b-4(f)(1)⁶ thereunder for it constitutes a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule. At any time within sixty days of the filing of this proposed rule change, the Commission may summarily abrogate such rule change if it appears

³ The Commission has modified the text of the summaries prepared by OCC.

⁴ Securities Exchange Act Release Nos. 42195 (December 8, 1999), 64 FR 68712 [File No. SR-OCC-99-09] (notice of filing proposing to merge the equity and non-equity elements of the OCC's clearing fund); 42897 (June 5, 2000), 65 FR 36750 [File No. SR-OCC-99-09] (order allowing OCC to merge its equity and non-equity clearing funds into a single clearing fund).

⁵ 5 U.S.C. 78s(b)(3)(A)(i).

⁶ 17 CFR 240.19b-4(f)(1).

to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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 Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of OCC. All submissions should refer to File No. SR-OCC-2001-14 and should be submitted by December 4, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁷

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45013; File No. SR-Phlx-2001-97]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment Numbers 1 and 2 by the Philadelphia Stock Exchange, Inc. Relating to Competing Specialists

November 2, 2001.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934¹ ("Act"), and Rule 19b-4 thereunder,² notice is hereby given that on October 22, 2001, the Philadelphia Stock

¹ 17 CFR 200.30-3(a)(12).

² 15 U.S.C. 78s(b)(1).

³ 17 CFR 240.19b-4.

⁴ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² A copy of the text of OCC's proposed rule change and the attached exhibit are available at the Commission's Public Reference Section or through OCC.

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 Phlx. The Exchange filed with the Commission Amendments 1 and 2 on October 30, 2001 and October 31, 2001 respectively. The Commission is publishing this notice to solicit comments on the proposed rule change and amendments from interested persons.

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

Phlx proposes to establish a competing specialist program. Specifically, the Exchange proposes to adopt new Phlx Rule 460, which contains a specific procedure for application, withdrawal and participation in the Competing Specialist Program, new Phlx Rule 517, which integrates Competing Specialists into the existing equity allocation rules, and new section (f) of Phlx Rule 506 which imposes a 3 business day notice requirement for specialists withdrawing from their equity securities. Phlx also proposes to adopt new Phlx Rule 229A providing for PACE order executions in a competing specialist environment and new Phlx Rule 229B providing for an Order Entry Window, a new feature of the Exchange's equity trading system. Finally, the Exchange proposes to amend Phlx Rule 155 regarding the obligations of a Floor Broker to clarify the nature of such obligations in a competing specialist environment. The following is the text of the proposed rule change (all new language in italics):

Rule 229A Operation of PACE System When Competing Specialists Are Trading

(a) *Applicability.* This Rule 229A applies only where a *Competing Specialist* (as defined below) has been approved by the *Equity Allocation, Evaluation and Securities Committee* pursuant to Rule 460 and has commenced its competing specialist operations. This rule applies to orders which are entered into the PACE system pursuant to Rule 229, *Philadelphia Stock Exchange Automated Communication and Execution System*.

(b) *Defined Terms.* (1) "*Directed Order*" shall mean an order that a member organization directs to a particular specialist pursuant to an agreement with that specialist in which the member organization agrees to place orders in the security with that specialist.

(2) "*Non-Directed Order*" shall mean an order which is not directed to a particular specialist.

(3) "*Directed Specialist*" shall mean the specialist to whom a *Directed Order* is directed. In any given case the *Directed Specialist* may be the *Primary Specialist* (as defined below) or a *Competing Specialist*.

(4) "*Non-Directed Specialist*" shall mean any specialist other than the specialist to whom a *Directed Order* is directed.

(5) "*Primary Specialist*" shall mean the primary specialist identified as such by the *Equity Allocation, Evaluation and Securities Committee*. The *Primary Specialist* may be either the *Directed Specialist* or the *Non-Directed Specialist* in the case of any particular *Directed Order*. The *Primary Specialist* shall be deemed to be the *Directed Specialist* with respect to any *Non-Directed Order*.

(6) "*Competing Specialist*" shall mean any competing specialist identified as such by the *Equity Allocation, Evaluation and Securities Committee* pursuant to Rule 460. A *Competing Specialist* may be either the *Directed Specialist* or the *Non-Directed Specialist* in the case of any particular *Directed Order*.

(7) "*PACE*" shall mean the Exchange's automatic order routing, delivery, execution and reporting system for equity securities which is governed by Rule 229, *Philadelphia Stock Exchange Automated Communication and Execution System*.

(8) "*API*" shall mean the PACE automatic price improvement feature which specialists may elect to activate pursuant to Rule 229, *Supplementary Material .07(c)(i)*.

(9) "*Extend API*" shall mean the PACE quote feature which a *Directed Specialist* may elect to activate and which will commit the *Directed Specialist* to extend the maximum size of his API guarantee up to the volume specified in the *Directed Specialist's* manual principal quote when the quote is at or part of the NBBO and at the same time greater than his automatic execution level.

(10) "*API Execution Price*" shall mean the execution price of an order which is better than the NBBO price as a result of the application of API.

(11) "*API Situation*" shall mean a situation where (a) *Extend API* applies, or (b) the *Directed Specialist* has elected to activate API and where the size of the NBBO spread and the size of the order are such that an *API Execution Price* is available pursuant to the terms of Rule 229, *Supplementary Material Rule .07(c)*.

(12) "*Calculated Automatic Execution Level*" shall mean the lower of (a) the automatic execution level established by the *Specialist* under Rule 229, *Supplementary Material .05*, or (b) the size of the NBBO market if the *Specialist* has activated *Volume Check* (as defined below); provided, however, that in no event shall the *Calculated Automatic Execution Level* be less than the minimum automatic execution level established by the Exchange under Rule 229.

(13) "*Step-Up API*" shall mean the PACE system's quote feature whereby a *Non-Directed Specialist* commits to trade against any *Directed Specialist's* *Directed Orders* at the *Directed Specialist's* *API Execution Price*.

(14) "*Specialist*" "All references in this rule to a specialist, including references to a *Directed Specialist*, a *Non-Directed Specialist*, a *Primary Specialist*, or a *Competing Specialist*, shall be deemed to be references to a specialist unit and not to an individual specialist.

(15) "*Volume Check*" shall mean the PACE system feature which may be activated by a specialist on a security by security basis and which, when activated, will prevent the automatic execution of incoming orders (within the *Directed Specialist's* automatic execution level) if the size of the NBBO market is less than the size of the incoming order.

(c) *PACE Guarantees.* Each specialist shall determine his minimum PACE acceptance (delivery) and automatic execution guarantees with respect to a security as provided in Rule 229. An order may be automatically executed up to the aggregate of the *Directed Specialist's* automatic execution guarantee combined with the quoted size of each *Non-Directed Specialist*. The price of any order automatically executed against either the *Directed Specialist* or any *Non-Directed Specialist* shall be (1) the NBBO, or (2) if the *Directed Specialist* has activated API, the *API Execution Price* established by the *Directed Specialist*. Notwithstanding Rule 229 *Supplementary Material .02* which would otherwise permit each specialist to determine whether to provide automatic execution parameters to non-agency orders, both agency and non-agency orders under Rule 229A will be executed against *Non-Directed Specialists* as provided herein, without distinction.

(d) *PACE Delivered Orders Executed Manually.* All orders which are to be executed manually pursuant to the terms of Rule 229 shall be executed manually by the *Directed Specialist*.

(e) PACE Order Execution Rules for Market and Marketable Limit Orders. In circumstances where orders are not to be executed manually pursuant to subsection (d) above, where the bid (offer) is comprised of an order on the book or agency interest represented in a Directed or Non-Directed Specialist's quote, then consistent with Rules 119, 120 and 218, an incoming eligible sell (buy) market or marketable limit order is executable based on price and time priority first against such book or agency interest and then as follows:

(1) No Non-Directed Specialist Quoting at NBBO. If at the time the order is received, there are no Non-Directed Specialists quoting at the NBBO, the order is executed against the Directed Specialist as provided in Rule 229.

(2) Non-Directed Specialist Quoting at NBBO and Directed Specialist Not Quoting at NBBO. If at the time the order is received, any Non-Directed Specialist is quoting at the NBBO and the Directed Specialist is not quoting at the NBBO, orders are to be executed as follows:

(A) In cases that are not an API Situation,

(i) If the Directed Specialist has not activated API or if the spread is too small to permit API to occur pursuant to Rule 229, then the order is to be automatically executed against the Non-Directed Specialist up to the Non-Directed Specialist quote size. Any remainder shall (a) if such remainder is equal to or less than the Directed Specialist's Calculated Automatic Execution Level, be automatically executed against the Directed Specialist, up to the Directed Specialist's Calculated Automatic Execution Level, or (b) if such remainder is greater than the Directed Specialist's Calculated Automatic Execution Level, be executed manually by the Directed Specialist; or

(ii) If the Directed Specialist has activated API and if the spread is sufficiently wide to permit API pursuant to Rule 229 Supplementary Material Rule .07(c), but the size of the order is greater than the Directed Specialist's Calculated Automatic Execution Level, then the order would be executed manually by the Directed Specialist.

(B) In an API Situation, the order shall be executed as follows.

(i) If the Non-Directed Specialist has activated Step-Up API, the order shall be executed against the Non-Directed Specialist up to the Non-Directed Specialist's quote size. Any remainder shall, if such remainder is equal to or less than the Directed Specialist's Calculated Automatic Execution Level,

be automatically executed against the Directed Specialist.

(ii) If the Non-Directed Specialist has not activated Step-Up-API, the order shall be executed against the Directed Specialist as provided in Rule 229.

(3) Directed Specialist and any Non-Directed Specialist Both Quoting at NBBO. If at the time the order is received both the Directed and any Non-Directed Specialists are quoting at the NBBO, then, regardless of which specialist first quoted at the NBBO prior to the time the order was received:

(A) In cases that are not an API Situation, the order is to be executed as follows.

(i) If the Directed Specialist has not activated API or if the spread is too small to permit API to occur pursuant to Rule 229, then the order is to be executed automatically against the Directed Specialist if the order is less than or equal to the Directed Specialist's automatic execution level, otherwise (a) against the Directed Specialist up to an amount (the "Directed Specialist's Component") equal to (I) his quoted size, plus (II) the remainder of the order size less the Non-Directed Specialist's quoted size, and (b) against the Non-Directed Specialist up to the Non-Directed Specialist's quoted size.

(ii) If the Directed Specialist has activated API and if the spread is sufficiently wide to permit API pursuant to Rule 229 Supplementary Material Rule .07(c), but the size of the order is greater than the Directed Specialist's Calculated Automatic Execution Level and

(I) If the Directed Specialist's quote size is less than or equal to the Directed Specialist's automatic execution level established pursuant to Rule 229, Supplementary Material .05, then the order would be executed manually by the Directed Specialist, or

(II) If the Directed Specialist's quote size is greater than the Directed Specialist's automatic execution level established pursuant to Rule 229, Supplementary Material .05, then the order would be executed automatically up to the Directed Specialist's quote size, with the remainder handled manually by the Directed Specialist.

(B) In an API Situation, the order shall be executed as follows:

(i) If the Non-Directed Specialist has not activated Step-Up API, the order shall be executed as provided in Rule 229.

(ii) If the Non-Directed Specialist has activated Step-Up API, the order is to be executed as provided in section (e)(3)(A) above.

(4) Multiple Non-Directed Specialists. In any case under (1) through (3) above

where an order is executable in full or in part against multiple Non-Directed Specialists because they are each quoting at the NBBO, the portion of the order to be executed against such Non-Directed Specialists will be automatically executed against them based upon time priority.

Rule 460 Procedures for Competing Specialists

(a) Application

Any specialist unit approved pursuant to Rule 501 can apply to the Exchange to function as a competing specialist unit (as opposed to a primary specialist) pursuant to the following procedures.

(i) Application to become a competing specialist must be directed to the Equity Allocation, Evaluation and Securities Committee (the "ES Committee") in writing on the appropriate form submitted to the appropriate Exchange department and must list, in order of preference, the securities in which the applicant seeks to be a competing specialist.

(ii) Once a competing specialist application is received by the Exchange, a written notification will be issued to the primary specialist. Each primary specialist is required to sign and date such notification acknowledging receipt, and return the notification to the Securities Department representative. Any objection by the primary specialist in one or more of such specialist's securities must be in writing on a form designated by the Exchange and filed with the Exchange within 48 hours of notice of the competing specialist's application. Only the primary specialist can object to a competing specialist application in his/her securities. The objection will be considered by the EAES Committee in reviewing the application.

All applicant specialist units, existing or newly created, must satisfy the EAES Committee that they have sufficient staff to enable them to fulfill the functions of a specialist as set forth in Rule 203, in all of the securities in which the applicant will be registered either as a primary or a competing specialist. The EAES Committee will determine whether to approve the application based upon the criteria set forth in Rule 511(b) as well as any objection by the primary specialist. The decision may be appealed consistent with Exchange By-laws and procedures.

(b) Obligations

Each competing specialist unit must be registered with the Exchange as such and must meet the current minimum requirements for specialists as set forth

in Exchange Rules, including the minimum capital and equity requirements, and must conform to all other performance requirements, standards, policies and rules set forth in the Rules of the Exchange.

(c) *Withdrawal*

If a competing specialist seeks to withdraw from acting as such in a security, it should so notify the Committee at least three business days prior to the desired effective date of such withdrawal. Withdrawal by a competing specialist bars that Competing Specialist from applying to compete in that same security for 90 days following the effective date of withdrawal. When the primary specialist requests to withdraw from a security, it shall be posted for reallocation by the EAES Committee. In the interim, if the EAES Committee is satisfied that a competing specialist can continue to maintain a fair and orderly market in such security, the competing specialist shall serve as the primary specialist until the security has been reallocated. Where there is more than one competing specialist in the security, a primary specialist shall be selected from among the competing specialists by the EAES Committee until reallocation.

(d) *Competing Markets in a Security*

(i) Notwithstanding the existence of competing specialist situations, there is only one Exchange market in a security. Each specialist (primary or competing) shall quote their own market. Competing specialists must cooperate with the primary specialist regarding openings, halts and reopenings to ensure that they are unitary. One market, the Phlx Best Bid/Offer ("PBBO"), will be disseminated.

(ii) Competing and primary specialists in a particular security must keep each other informed and communicate to inquiring Floor Brokers the full size of any executable "all or none" orders or any other order in their possession that cannot be represented in the published quote. Competing specialists are expected to represent such orders on a "best efforts" basis to ensure the execution of the entire order at a single price or prices, or not at all.

Rule 229B Order Entry Window

Floor Brokers and Specialists may elect to enter orders through an order entry window (the "Order Entry Window" or "OEW"), which will route orders to the appropriate specialist, in accordance with Rule 229A, with all OEW orders treated as Non-Directed Orders, as that term is defined in Rule

229A. Specialists may enter orders only in those stocks that they have been approved to trade as a specialist by the Equity Allocation, Evaluation and Securities Committee. Orders sent through the OEW will be displayed to the specialist for a period of time to be determined by the Exchange. During that time, the specialist can choose to interact with the OEW order. At the end of the time period, absent previous specialist action, the OEW order will be automatically executed or cancelled.

Rule 506 (new language is italic)

(a)–(e) [no change]
(f) If a specialist seeks to withdraw from acting as such in a security, it should so notify the Committee at least three business days prior to the desired effective date of such withdrawal.

Rule 517 Competing and Remote Competing Specialist

Rules governing the approval of trading as a competing specialist and as a remote competing specialist are set forth in 460, Procedures for Competing Specialists and Rule 461, PACE Remote Specialist, respectively, and are incorporated by reference herein. Rules 500 through 599 shall apply both to the specialist selected by the Committee following solicitation of applications under Rule 506(a) to serve as primary specialist and to any competing specialist approved under Rule 460, except that the primary specialist shall determine whether a security shall be PACE registered. Applications for allocation of competing specialist privileges pursuant to Rule 460 shall contain the information required in Rule 506(b), and competing specialist privileges may be terminated on the same basis that primary specialist privileges may be removed and reallocated.

Rule 155 General Responsibility of Floor Brokers (new language italic)

A Floor Broker handling an order is to use due diligence to execute the order at the best price or prices available to him in accordance with the Rules of the Exchange. A Floor Broker may (a) enter an order into the Order Entry Window as provided in Rule 229B, or (b) take the order to the specialist in that security on the trading floor or, where there are competing specialists, to the primary specialist in that security.

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

In its filing with the Commission, 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.

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 adopt a Competing Specialist Program on the Exchange. The purpose of each proposed rule is discussed below.

Rule 460 Procedures for Competing Specialists

The purpose of proposed Rule 460 is to establish a framework pursuant to which multiple specialists could trade on the equity trading floor of the Exchange.³ Currently, there is one specialist unit (referred to herein as the "Primary Specialist") for each equity security traded on the floor. This Primary Specialist is approved by the Exchange's Equity Allocation, Evaluation and Securities Committee (the "EAES Committee")⁴ pursuant to applications solicited by the Exchange under Rule 506(a) and criteria set forth in Rule 511(b). Those rules, generally, provide for the allocation of equity securities (commonly called "books") to particular specialist units, which consist of specialists and other staff.⁵

Proposed Rule 460 would permit approved specialist units to apply to trade in a given security as Competing Specialists. The Primary Specialist would continue to trade as well and would have certain privileges and responsibilities that a Competing Specialist would not have.⁶ The

³ The Exchange is also separately proposing new Rule 461, which would provide for the trading by Competing Specialists from a remote location. See SR-Phlx-2001-98. Additionally, this proposed rule change dealing with Competing Specialists will have no impact on Exchange Rules 201A and 202A dealing with Alternate Specialists. Exchange specialists approved as Alternate Specialists may continue to trade in that capacity regardless of the existence of Competing Specialists.

⁴ See By-Law Article 10-6 and Rule 500.

⁵ See Rule 501.

⁶ For example, the Primary Specialist determines whether or not a security will trade on or off the PACE system. If the Primary Specialist determines that the security will trade on PACE, then all Competing Specialists must trade that security on PACE. If the Primary Specialist elects to take the security off the PACE system, the security is subject to reallocation to another specialist unit willing to

Exchange's proposal does not limit the number of Competing Specialists in each security (in addition to the Primary Specialist), but each shall be approved by the EAES Committee. Each Competing Specialist would have the same affirmative and negative obligations under Phlx Rule 203 as are imposed on the Primary Specialist.

The proposal is intended to attract additional order flow to the Exchange. In addition, the Competing Specialist program should encourage specialist units to actively market their services, as well as benefits and guarantees provided by Phlx rules, to a new customer base.

Proposed Rule 460 consists of four sections dealing with application for approval as a Competing Specialist, the obligations of a Competing Specialist once approved, the withdrawal of a Competing Specialist from Competing Specialist status in a security, and a description of competing markets in a security. Proposed Rule 460(a) provides that Competing Specialist applications are to be submitted in writing on the appropriate form to the EAES Committee and must list in order of preference the securities in which the applicant intends to function as a Competing Specialist. The EAES Committee will make a determination whether to approve such application based on the factors set forth in Rule 511(b) for the selection of a Primary Specialist in a security, in addition to any objection that may have been registered with the EAES Committee by the Primary Specialist in that security.⁷ The EAES Committee will not approve any application to act as a Competing Specialist in any security not traded on the Exchange's PACE System.⁸

trade the security on the PACE system. See Rule 520-523. Additionally, under proposed new Rule 229A (see below), the Primary Specialist will be deemed to be the Directed Specialist with respect to any Non-Directed Orders. Pursuant to Rule 155, also described further below, floor brokers must represent orders to the Primary Specialist, except as provided for in proposed Rule 229B. Under this proposal, there must be a Primary Specialist in order for there to be Competing Specialists.

⁷ Although the Exchange seeks approval to trade all equity securities in its competing specialist program, the Exchange intends initially to limit the competing specialist program to common stock. The Exchange may determine to include other equity securities, such as Trust Shares, Index Fund Shares and Trust Issued Receipts, in the competing specialist program at a later date.

⁸ The Exchange notes that pursuant to Rule 522 any security not traded on the PACE system may be reallocated to a specialist that is willing to trade the security on PACE. Thus, if a security is unavailable to be traded by a Competing Specialist because it is not on PACE, any specialist unit which otherwise may have applied to trade the security as a Competing Specialist may apply to trade the security as the Primary Specialist pursuant to Rule

Proposed Rule 460(b) establishes that each Competing Specialist must be registered with the Exchange as such and must meet all current minimum requirements for specialists. Thus, each Competing Specialist is to meet the same minimum standards applicable to the Primary Specialist. For instance, a Competing Specialist must meet the financial responsibility requirements of Rule 703.⁹

Proposed Rule 460(c) outlines the procedures for Competing Specialists who wish to withdraw from the Competing Specialist program in a particular security. The Competing Specialist is required to give three business days notice to the Exchange prior to the withdrawal.¹⁰ Rule 460(c) would bar any competing specialist from applying for that same security for a period of ninety days following the effective date of withdrawal.

If a Primary Specialist requests to be relieved of a security, the security is to be posted for reallocation by the EAES Committee and, in the interim, one of the Competing Specialists may be required to serve as the Primary Specialist until reallocation.

Proposed Rule 460(d) establishes that each Primary Specialist and Competing Specialist shall quote its own market but that, nevertheless, there is only one Exchange market in a security. That one market, the Phlx best bid/offer, is disseminated; it may consist of aggregated sizes of various specialists. Further, the rule requires Competing Specialists to cooperate with the Primary Specialist regarding openings, halts and reopenings to determine they are unitary. It also requires Competing Specialists and Primary Specialists to keep each other informed and communicate to inquiring Floor Brokers the full size of any orders in their possession that cannot be represented in the published quote. These requirements are intended to address the co-existence of multiple specialists.

Rule 229A Operation of PACE System When Competing Specialists Are Trading

Today, Rule 229 governs execution of orders on the PACE system. Because the Exchange currently operates under a sole specialist system, Rule 229 does not address how orders would be executed if more than one specialist were making a market in a particular security;

522. Thereafter, the former Primary Specialist may apply to be a competing specialist.

⁹ The Exchange's Equity Floor Procedure Advices would also apply to Competing Specialists.

¹⁰ Proposed new Rule 506(f) would also impose a three-day notice of withdrawal requirement on all specialists, including Primary Specialists.

incoming PACE orders are generally executed against either the specialist, at the National Best Bid/Offer ("NBBO"),¹¹ or a PACE order on the book, as described further below.

New Rule 229A would provide an algorithmic handling of orders through the PACE system in cases where Competing Specialists are trading. The Rule 229 algorithm determines the specialist against which an incoming PACE order is executed, and details the amount of shares. Rule 229A builds on the guarantees and operation of the PACE System, as provided in Rule 229. Thus, how PACE operates is an important underpinning of this proposal.

The PACE System

By way of background, PACE is the Exchange's order routing, delivery, execution and reporting system, governed by Rule 229. Rule 229 is a voluntary system, such that specialists are not required to participate. Specialists who choose to participate in PACE are required to provide its guarantees to agency orders, including, among other things, accepting orders up to 2,099 shares for delivery and automatically executing eligible orders up to 599 shares. Above these minimum levels, specialists may set their delivery or execution levels at higher numbers.

Automatic execution is one of the features and guarantees of PACE. Only certain orders are eligible for automatic execution; other orders are handled manually even when delivered electronically. Certain conditions cause PACE orders to be handled manually, including when the execution price would be outside the high/low range of the day for that security (out-of-range protection) and when the execution would be at a down-tick. Certain orders are subject to a 30 second order exposure window prior to automatic execution, pursuant to Supplementary Material .05.

Another PACE guarantee under Rule 229 pertains to non-marketable limit orders. Specifically, Supplementary Material .10(a)(ii) provides that round-lot limit orders up to 500 shares and the round-lot portion of PRL limit orders up to 599 shares which are entered at a price different than the PACE Quote (non-marketable limit orders) will be executed in sequence at the limit price when an accumulative volume of 1,000 shares of the security named in the order prints at the limit price or better

¹¹ Rule 229 refers to the NBBO as the "PACE Quote."

on the New York market¹² after the time of entry of any such order into PACE. For each accumulation of 1,000 shares executed at the limit price on the New York market, the specialist shall execute a single limit order up to a maximum of 500 shares for each round-lot limit order up to 500 shares or the round-lot portion of a PRL limit order up to 599 shares. This guarantee is commonly referred to as primary market print protection.

With respect to non-agency orders, specialists may choose to accept non-agency orders¹³ under Rule 229.02, under the conditions specified in that rule. Specialists may also choose to accept orders through PACE without participating in PACE execution guarantees, where the entering member organization has generally elected not to receive such guarantees.

PACE also offers an automatic price improvement feature ("API"). API is a feature of the PACE system that automatically affords price improvement to eligible orders, pursuant to Rule 229.07(c). Specifically, API executes at a price better than the NBBO, in certain situations, by \$.01 or a percentage of the spread between the bid and offer, as determined by the specialist. Even when a specialist does not choose to activate API, the specialist is required by Rule 229.07(c)(ii) to manually provide double-up/double-down price protection to PACE orders.

In summary, the PACE System and Rule 229 together provide certain execution guarantees to eligible orders, including automatic execution at the NBBO.

Rule 229A Summary

In cases where only the Primary Specialist is trading a security, PACE orders will continue to be executed as provided in Rule 229, and Rule 229A would not apply. In cases where Competing Specialists are trading a security, Rule 229 would continue to apply to the extent that it is not inconsistent with Rule 229A. For example, the provisions of Rule 229 dealing with API (as well as many of the guarantees and obligations of Rule 229) would continue to apply in both

Competing Specialist and sole specialist situations.

To begin, new Rule 229A would apply to PACE orders where there is at least one Competing Specialist in a security. Paragraph (b) of Rule 229A provides a number of defined terms used throughout the rule. Most notably, "Directed Order" is defined to mean an order that a member organization directs to a particular specialist pursuant to an agreement with that specialist in which the member organization agrees to place orders in the security with that specialist. Any orders not placed with a particular specialist are called "Non-Directed Orders." The specialist to whom a Directed Order is directed is defined as the "Directed Specialist" and any other specialist (regardless of whether the Primary Specialist or a Competing Specialist) is defined as a Non-Directed Specialist. Thus, the identity of the Directed Specialist and the Non-Directed Specialist is determined on an order-by-order basis. The Primary Specialist¹⁴ is deemed to be the Directed Specialist with respect to any Non-Directed Orders.

Rule 229A defines a number of new procedures in the routing and execution of PACE orders that are affected by the bid (offer) posted by each specialist, whether each specialist is quoting at the NBBO, the automatic execution size of each specialist, the size of each specialist's bid (offer), the size of the NBBO, the spread of the NBBO as it relates to (whether API applies) application by the Directed Specialist, the activation of a step-up price improvement feature by Non-Directed Specialists and the priority of Non-Directed Specialist's bids (offers). The operation of these factors is discussed more fully below.

In summary, Rule 229A expressly preserves the priority of the limit order book consistent with Rules 119, 120 and 218. When there is no such order involved, Rule 229A will allow the Directed Specialist to trade against its own directed order flow and execute orders¹⁵ in accordance with Rule 229 where no other specialist is at the NBBO, or where just the Directed Specialist is at the NBBO. However, Rule 229A also permits the Non-Directed Specialist to trade against Directed Orders. Specifically, when a

Non-Directed Specialist is at the NBBO, he will attract away from the Directed Specialist part or all of Directed Order, depending on the size of the order and the applicability of the Directed Specialist's API level. Generally, if the Directed Specialist and other Non-Directed Specialists are at the NBBO, the Directed Specialist may retain part or all of an order depending on the size of the order and the applicability of the Directed Specialist's API or, in the case of Non-Directed Specialists, whether the PACE system's step-up automatic price improvement feature ("Step-Up API") has been activated by the Non-Directed Specialist. Where specialists are bidding/offering at the same price, time priority will prevail, except that a Directed Specialist will be given priority over any Non-Directed Specialist (despite time priority of any Non-Directed Specialist) when they are bidding (offering) at the NBBO. Other factors which play a part in the direction and execution of orders are the size of the NBBO and the activation of extended API by the Directed Specialist, all of which are discussed more fully below. Depending on the circumstances, when an overage of order volume exists, it will be sent to the Directed Specialist.

More specifically, the execution methodology of Rule 229A is divided into three scenarios, discussed in greater detail below.

No Non-Directed Specialist at NBBO

The first scenario, covered by paragraph (e)(1), is where, if at the time the incoming PACE order is received, there are no Non-Directed Specialists quoting at the NBBO, in which case the incoming order is executed against the Directed Specialist as provided in Rule 229,¹⁶ whether or not the Directed Specialist is quoting at the NBBO. The order would be automatically executed up to the Directed Specialist's automatic execution size or quote size, whichever is greater. For instance,¹⁷ where the market (NBBO) for a particular stock is \$50 × \$50.10 (10,000 × 10,000 shares), and the Phlx market (PBBO) is \$50 × \$50.15 (500 1,000 shares), with the Non-Directed Specialist bidding \$49.95 for 500 shares, an incoming order for 1,000

¹² Within the PACE Rule, New York market refers to the primary market, which is usually the New York Stock Exchange or the American Stock Exchange.

¹³ Agency orders are defined as orders entered on behalf of a public customer, and does not include any order entered for the account of a broker-dealer, the account of an associated person of a broker-dealer, or any account in which a broker-dealer or an associated person of a broker-dealer has any direct or indirect interest. See Securities Exchange Act Release No. 26968 (June 23, 1989), 54 FR 28141 (July 5, 1989)(SR-Phlx-89-13).

¹⁴ The Primary Specialist is the specialist identified as such by the EAES Committee.

¹⁵ See letter from Carla Behnfeldt, Director, Legal Department New Product Development Group, Phlx to John Riedel, Attorney Adviser, Division of Market Regulation ("Division"), Commission, dated October 30, 2001 ("Amendment No. 1"). Most references to orders hereinafter refer to an incoming PACE sell order.

¹⁶ The cross-reference to Rule 229 is intended, here and throughout Rule 229A, to capture the various guarantees and situations where automatic executions occur under the PACE Rule today.

¹⁷ In all of the examples provided in this proposed rule change for purposes of illustration, each specialist's maximum automatic execution level and API level is assumed to be 1,099 shares, and all quotes reflect the specialist's principal (not agency) interest, the order book is away from the market, and the PACE system's volume check feature (as described below) has been activated by the specialist.

shares would automatically execute against the Directed Specialist, whether he was bidding \$49.95 or \$50.00.¹⁸ This is because the Non-Directed Specialist was not quoting at the NBBO.

Where multiple Non-Directed Specialists are quoting at prices other than the NBBO, those quotes, even if better than the quote of the Directed Specialist, are not relevant because the execution price against the Directed Specialist is generally the NBBO or better. This is consistent with how the PACE System currently operates, as automatic executions occur at the NBBO, regardless of the (sole) specialist's actual quote.

Non-Directed Specialist at NBBO;
Directed Specialist Not at NBBO

Secondly, Rule 229A(e)(2) applies where the Directed Specialist is not quoting at the NBBO and at least one Non-Directed Specialist is quoting at the NBBO. In this sub-paragraph, how the order is executed depends on whether there is an API Situation. An API Situation is defined in Rule 229A as a situation: (a) where Extend API applies,¹⁹ or (b) where the Directed Specialist has elected to activate API and where the size of the NBBO spread and the size of the order are such that an API Execution Price is available pursuant to the terms of Rule 229, Supplementary Material Rule .07(c). In essence, an API Situation is where an API execution price (a price better than the NBBO) can be given by the system, because the specialist has activated the API feature and the situation would allow it.

In an API Situation (where the Directed Specialist is not quoting at the NBBO but a Non-Directed Specialist is), Rule 229A(e)(2)(B) provides that the incoming PACE order is executed against the Directed Specialist at the API price, unless the Non-Directed Specialist quoting at the NBBO has activated Step-Up API. Step-Up API is the PACE system's quote feature whereby a Non-Directed Specialist

commits to trade against any Directed Specialist's Directed Orders at the Directed Specialist's API Execution Price.²⁰ For example, where the market (NBBO) for a particular stock is \$50 × \$50.10 (10,000 × 10,000 shares), and the Phlx market (PBBO) is \$50 × \$50.15 (500 × 100 shares), with the Directed Specialist bidding \$49.95 for 500 shares (with API on) and the Non-Directed Specialist bidding \$50 for 500 shares (with Step-Up API not activated), an incoming order for 1,000 shares would automatically execute against the Directed Specialist at his API price (\$50.03). Even though he was quoting at a better price, the Non-Directed Specialist was unwilling to step up to the Directed Specialist's API price, such that he did not participate. Thus, if the Non-Directed Specialist has not activated Step-Up API, then Rule 229A(e)(2)(B)(ii) provides that the order shall be executed against the Directed Specialist.

If the Non-Directed Specialist has activated Step-Up API, Rule 229A(e)(2)(B)(i) provides that the order shall be executed against the Non-Directed Specialist at the Directed Specialist's API price up to the Non-Directed Specialist's quoted size. Any remainder that is less than the Directed Specialist's Calculated Automatic Execution Level ("CAEL")²¹ will be automatically executed against the Directed Specialist at his API price. For example, where the NBBO is \$50 × \$50.10 (10,000 × 10,000 shares), and the Phlx market is \$50 × \$50.15 (500 × 1,000 shares), with the Directed Specialist bidding \$49.95 for 500 shares (with API on) and the Non-Directed Specialist bidding \$50 for 500 shares (with Step-Up API activated), an incoming order for 1,000 shares would be automatically executed as follows: 500 shares against the Non-Directed Specialist at the Directed Specialist's API price (\$50.03) and 500 shares against the Directed Specialist at \$50.03. In this example,

each specialist receives their quoted size.

Rule 229A(e)(2)(A) applies where there is no API Situation and the Directed Specialist is not quoting at the NBBO, while at least one Non-Directed Specialist is. The two sub-paragraphs thereunder, in determining against whom the order is executed, focus on why there is no API Situation. Sub-paragraph (i) applies where the Directed Specialist has not activated API or the spread is too small to permit API to occur.²² In both cases, the incoming PACE order is automatically executable against the Non-Directed Specialist up to the Non-Directed Specialist's quoted size, because the Non-Directed Specialist is quoting at the NBBO. For example, where the NBBO is \$50 × \$50.01 (10,000 × 10,000 shares), and the Phlx market is \$50 × \$50.15 (500 × 100 shares), with the Directed Specialist bidding \$49.95 for 500 shares (with API on) and the Non-Directed Specialist bidding \$50 for 500 shares (with Step-Up API activated), an incoming order for 1,000 shares would be automatically executed 500 shares against the Directed Specialist and 500 shares against the Non-Directed Specialist. Because the spread is too small, neither API (even if activated) are applicable here.

In another example, where the NBBO is \$50 × \$50.01 (10,000 × 10,000 shares) and the Phlx market is \$50 × \$50.15 (2,000 × 100 shares), with the Directed Specialist bidding \$49.95 for 500 shares and the Non-Directed Specialist bidding \$50 for 2,000 shares, an incoming order for 2,000 would be automatically executed against the Non-Directed Specialist for 2,000 shares. The entire order went to the Non-Directed Specialist, because he was quoting at the NBBO for the entire size of that order.

Rule 229A(e)(2)(A)(i) further provides that any remainder of an incoming PACE order is automatically executed against the Directed Specialist up to the Directed Specialist's CAEL. Referring back to the prior example, where the NBBO is \$50 × \$50.01 (10,000 × 10,000 shares) and the Phlx market is \$50 × \$50.15 (2,000 × 100 shares), with the Directed Specialist bidding \$50 for 2,000 shares, an incoming order for 2,200 shares would be automatically executed against the Non-Directed Specialist for 2,000 shares (who was quoted at the NBBO) and 200 shares against the Directed Specialist. If the

¹⁸ If the Directed Specialist was bidding for 1,200 shares, an incoming order for 1,200 shares would automatically execute against him, because his 1,099 automatic execution level would be extended to his quoted size of 1,200 shares.

¹⁹ Extend API is defined as the PACE quote feature which a Directed Specialist may elect to activate and which will commit the Directed Specialist to extend the maximum size of his API guarantee up to the volume specified in the Directed Specialist's manual principal quote when the quote is at or part of the NBBO and at the same time greater than his automatic execution level. If the Directed Specialist activates Extend API, an order could automatically execute against the Directed Specialist for a size greater than his automatic execution (maximum) level, up to his quoted size.

²⁰ Step-Up API does not apply to a specialist's own directed orders, because API would: Step-Up API only applies to Non-Directed Specialists, because it is a way of stepping up to someone else's API price that would otherwise apply to that order.

²¹ The CAEL is the lower of (a) the automatic execution level established by the Specialist under Rule 229, Supplementary Material .05 (599 shares or more), or (b) the size of the NBBO market if the Specialist has activated Volume Check (as defined below); provided, however, that in no event shall the Calculated Automatic Execution Level be less than the minimum automatic execution level established by the Exchange under Rule 229 (599 shares). Volume Check is the PACE system feature which may be activated by a Specialist on a security by security basis and which, when activated, will prevent the automatic execution of incoming orders if the size of the NBBO market does not equal or exceed the Directed Specialist's automatic execution level.

²² API only operates where the spread is: (1) \$.02 or greater where the specialist chooses to give API in the form of a percentage of the spread; or (2) either \$.03 or \$.05, depending on the specialist's choice, where the specialist chooses to give API of \$.01.

remainder of the order is greater than the Directed Specialist's CAEL, then the order is handled manually by the Directed Specialist. For instance, where the NBBO is $\$50 \times \50.01 (10,000 \times 10,000 shares) and the Phlx market is $\$50 \times \50.15 (500 \times 100 shares), with the Directed Specialist bidding \$49.95 for 500 shares and the Non-Directed Specialist bidding \$50 for 500 shares, an incoming order for 2,000 shares is automatically executed 500 shares against the Non-Directed specialist and 1,500 shares are handled manually by the Directed Specialist.

Rule 229A(e)(2)(a)(ii) applies where there is no API situation for a different reason. If there is not an API Situation because, although the Directed Specialist has activated API and the spread is sufficiently wide to permit API, the size of the incoming order is too large (it exceeds the Directed Specialist's CAEL), the order would be executed manually by the Directed Specialist. For example, where the NBBO is $\$50 \times \50.10 (10,000 \times 10,000 shares), and the Phlx market is $\$50 \times \50.15 (2,000 \times 100 shares), with the Directed Specialist bidding \$49.95 for 500 shares (with API on) and the Non-Directed Specialist bidding \$50 for 2,000, an incoming order for 2,000 shares would be manually handled by the Directed Specialist, because the volume of the incoming order (2,000 shares) exceed the Directed Specialist's CAEL—both his automatic execution level (1,099 shares) and his quote size (500 shares).

Directed Specialist and a Non-Directed Specialist at NBBO

The third situation is where the Directed Specialist and a Non-Directed Specialist are quoting at the NBBO; Rule 229A(e)(3) applies. The execution of the incoming PACE order depends on whether there is an API Situation, regardless of which specialist quoted at the NBBO first. Rule 229A(e)(3)(A) applies where there is no API Situation. Pursuant to Rule 229A(e)(3)(A)(i), if the Directed Specialist has not activated API or if the spread is too small for API to occur, the order is to be executed automatically against the Directed Specialist if it is within his automatic execution level, otherwise against the Directed Specialist up to his quoted size, then against any Non-Directed Specialist quoting at the NBBO up to his quoted size, with the remainder manually against the Directed Specialist. Thus, the Directed Specialist has priority up to his quoted size, regardless of whether any Non-Directed Specialist may have quoted at the NBBO first.

For example, where the NBBO is $\$50 \times \50.01 (10,000 \times 10,000 shares), and the Phlx market is $\$50 \times \50.15 (1,000 \times 100 shares), with the Directed Specialist bidding \$50 for 500 shares and the Non-Directed Specialist bidding \$50 for 500 shares, an incoming order for 1,000 shares would automatically execute against the Directed Specialist. An incoming order for 1,500 shares would automatically execute against the Directed Specialist for 1,000 shares and against the Non-Directed Specialist for 500 shares.

The size of the order may result in manual handling of the Directed Specialist's portion. For instance, referring back to the prior example, an incoming order for 1,700 shares would automatically execute against the Non-Directed Specialist for 500 shares, and 1,200 shares would be handled manually by the Directed Specialist. The 1,200 shares exceeds the Directed Specialist's automatic execution level, as well as his quote size.

In a similar example, where the NBBO is $\$50 \times \50.01 (500 \times 10,000 shares), the Phlx market is $\$50 \times \50.15 (400 \times 100 shares), the Directed and Non-Directed Specialist are each bidding \$50 for 200 shares, an incoming order for 1,000 shares would automatically execute 200 shares against the Non-Directed Specialist and 800 shares would be handled manually by the Directed Specialist. Only 200 shares would automatically execute in this example because 800 shares (although within the Directed Specialist's automatic execution level) exceeds the NBBO size (which is 500 shares). Thus, 800 shares exceeds the Directed Specialist's CAEL.²³

Where the NBBO is $\$50 \times \50.01 (10,000 \times 10,000 shares)²⁴ and the Phlx market is $\$50 \times \50.15 (1,700 shares \times 100 shares) with the Directed Specialist is bidding \$50 for 1,200 shares and the Non-Directed Specialist is bidding \$50 for 500 shares, an incoming order for 2,000 shares would automatically execute 500 shares against the Non-Directed Specialist, 1,200 shares automatically against the Directed Specialist and 300 shares would be manually handled by the Directed Specialist; this is because the Directed Specialist's quoted size of 1,200 shares is greater than his automatic execution level of 1,099 shares.

²³ If volume check were not activated, the order would have automatically executed.

²⁴ Telephone call between Carla Behnfeldt, Director, Legal Department New Product Development Group, Phlx and John Riedel, Attorney Adviser, Division, Commission, dated October 31, 2001 ("Amendment No. 2").

Where the Directed Specialist is bidding for 500 shares and the Non-Directed Specialist is bidding for 1,200 shares, an incoming order for 2,000 shares would automatically execute 1,200 shares against the Non-Directed Specialist and 800 shares against the Directed Specialist; this is because 800 shares is less than the Directed Specialist CAEL.

There is a second scenario where there is no API situation, which is covered by Rule 229A(e)(3)(A)(ii). If the Directed Specialist has activated API and the spread is sufficiently wide for API to occur, but the order size is too big (it exceeds the Directed Specialist's CAEL and the Directed Specialist's quote size exceeds his automatic execution level), then the order would be automatically executed up to the Directed Specialist's quote size, with the remainder handled manually by the Directed Specialist. For example, where the NBBO is $\$50 \times \50.10 (10,000 \times 10,000 shares), and the Phlx market is $\$50 \times \50.15 (1,700 \times 100 shares), with the Directed Specialist bidding \$50 for 1,200 shares and the Non-Directed Specialist bidding \$50 for 500 shares, an incoming order for 2,000 shares would automatically execute 500 shares against the Non-Directed Specialist and 1,200 shares against the Directed Specialist, with the remaining 300 shares handled manually by the Directed Specialist. The 1,200 shares was automatically executed against the Directed Specialist because that was his quote size (even though greater than his automatic execution size).

If the order size exceeds the Directed Specialist's CAEL, but his quote size does not exceed his automatic execution level, then the order would be handled manually by the Directed Specialist. For example, where the NBBO is $\$50 \times \50.10 (10,000 \times 10,000 shares) and the Phlx market is $\$50 \times \50.15 (1,700 \times 100 shares), with the Directed Specialist bidding \$50 for 600 shares and the Non-Directed Specialist is bidding \$50 for 500 shares, an incoming order for 2,000 shares would automatically execute 500 shares against the Non-Directed Specialist and 1,500 shares would be handled manually by the Directed Specialist. In this example, the Directed Specialist's portion is handled manually because his quote size is less than his automatic execution level.

Even if there is an API Situation, this result may occur—that the Directed Specialist gets priority and an automatic execution up to his quoted size or the ability to execute the entire order manually—where the Non-Directed Specialist has not activated Step-Up API. This is provided for in Rule

229A(e)(3)(B)(ii), which cross-references Rule 229A(e)(3)(A).

If there is an API situation where a Non-Directed Specialist is quoting at the NBBO and the Directed Specialist is not, then how an incoming order is executed depends on whether the Non-Directed Specialist has activated Step-Up API. If the Non-Directed Specialist has not activated Step-Up API, the order is executable against the Directed Specialist at the Directed Specialist's API price, and pursuant to Rule 229A(e)(3)(A)(i) and (ii).

For example, where the NBBO is $\$50 \times \50.10 (10,000 \times 10,000 shares), and the Phlx market is $\$50 \times \50.15 (1,700 \times 100 shares), with the Directed Specialist bidding $\$50$ for 1,200 shares (with API on) and the Non-Directed Specialist bidding $\$50$ for 500 shares (with Step-Up API not activated), an incoming order for 1,000 shares would automatically execute against the Directed Specialist at $\$50.03$.

An incoming order for 2,000 shares would execute as follows against the Directed Specialist: 1,200 shares automatically at the Directed Specialist's API price ($\$50.03$) and 800 shares to be handled manually. In this example, the Non-Directed Specialist does not participate in the incoming order because he was unwilling to step up to the Directed Specialist's API price of $\$50.03$. This example also illustrates that 1,200 shares automatically execute against the Directed Specialist, even though his automatic execution level is only 1,099 shares because his quote size of 1,200 shares extended his automatic execution size to 1,200 shares.

If the Non-Directed Specialist has activated Step-Up API, the order is executable against the Directed Specialist at the Directed Specialist's API price up to the Directed Specialist's quoted size, and then against the Non-Directed Specialist, up to his quoted size, with the remainder to the Directed Specialist. If the Directed Specialist's quote size is greater than his automatic execution level, then the remainder is automatically executed up to the quote size and the rest is handled manually. If the Directed Specialist's quote size is less than his automatic level, then the remainder is either all automatically executed or all handled manually, depending on the size.

For example, where the NBBO is $\$50 \times \50.10 (10,000 \times 10,000 shares), and the Phlx market is $\$50 \times \50.15 (1,700 \times 100 shares), with the Directed Specialist bidding $\$50$ for 1,200 shares (with API on) and the Non-Directed Specialist bidding $\$50$ for 500 shares (with Step-Up API activated), an incoming order for 1,000 shares would

automatically executed against the Directed Specialist, because 1,000 shares is within the quoted size.

An incoming order for 2,000 shares would execute as follows: 500 shares automatically against the Non-Directed Specialist at the Directed Specialist's API price of $\$50.03$, 1,200 shares automatically against the Directed Specialist at the API price, and 300 shares would be handled manually by the Directed Specialist; this is because the order was automatically executed up to his quote size with the remainder handled manually.

The next example demonstrates how the size of the quote impacts the outcome. First, where the market (NBBO) for a particular stock is $\$50 \times \50.10 (10,000 \times 10,000 shares), and the Phlx market (PBBO) is $\$50 \times \50.15 (2,700 \times 100 shares), with the Directed Specialist bidding $\$50.00$ for 1,200 shares (with API on) and the Non-Directed Specialist bidding $\$50$ for 1,500 shares (with Step-Up API activated), an incoming order for 2,000 shares would execute as follows: 1,200 shares automatically against the Directed Specialist at his API price of $\$50.03$ and 800 automatically against the Non-Directed Specialist at the Directed Specialist's API price. This example shows that the Directed Specialist has priority and gets filled first up to his quoted size.

Multiple Non-Directed Specialists

Rule 229A(e)(4) provides that where multiple Non-Directed Specialists are quoting at the NBBO, each will be treated with time priority. For example, where the NBBO is $\$50 \times \50.10 (10,000 \times 10,000 shares), and the Phlx market is $\$50 \times \50.15 (2,200 \times 100 shares), with the Directed Specialist bidding $\$50$ for 1,200 shares (with API on) at 10:05 AM, Non-Directed Specialist 1 bidding $\$50$ for 500 shares (with Step-Up API activated) at 10:00 AM, and Non-Directed Specialist 2 bidding $\$50$ for 500 shares at 10:01 AM, an incoming order for 2,000 shares would automatically execute against the Directed Specialist for 1,200 shares at his API price of $\$50.03$, 500 shares against Non-Directed Specialist 1 at $\$50.03$ and 300 shares against Non-Directed Specialist 2 at $\$50.03$.

Rule 155 General Responsibility of Floor Brokers

Rule 155 currently provides that a Floor Broker is to use due diligence to execute orders at the best prices available to him in accordance with the Rules of the Exchange. This rule is proposed to be revised to establish how a Floor Broker may discharge his or her

due diligence obligation where there is more than one specialist. As revised, the Floor Broker's obligation would be discharged if he or she enters the order into the Order Entry Window under Rule 229B (see below), or (b) takes the order to the specialist in that security on the trading floor or, where there are competing specialists, to the Primary Specialist in that security. This rule is intended to establish that Floor Brokers must represent orders to the Primary Specialist, unless relying on the Order Entry Window of Rule 229B.

Rule 229B Order Entry Window

New Rule 229B would provide for a new feature of the Exchange's equity trading system, the Order Entry Window ("OEW"). The OEW would allow members the ability to access or probe the internal Phlx market. Specialists may enter orders only in those stocks that they have been approved to trade as a specialist by the EAES Committee. Orders entered into the OEW will be routed to the appropriate Phlx specialists (Competing and Primary), in accordance with Rule 229A as a Non-Directed Order.²⁵ For example, where there is no Competing Specialist quoting at the NBBO, the OEW would route an incoming order to the Directed Specialist—in this example, the Primary Specialist. Unlike PACE orders, however, orders routed to a specialist by the OEW will not be immediately executed according to the Rule 229A algorithm but will be displayed for a period of time, to be determined by the Exchange. During that time, the specialist can choose to interact with the OEW order. For instance, the specialist may choose to execute the order. At the end of the time period, absent previous specialist action, the OEW order will be automatically executed, if executable, or cancelled. The OEW is intended to serve as an order routing mechanism for Floor Brokers as well as specialists seeking to access other specialists' markets.

Rule 517

Proposed Rule 517 incorporates Rules 460 and 461 by reference into the 500—599 series of Exchange rules. The purpose of Rule 517 is to integrate the provisions of the Competing Specialist and Remote Specialist rules into the existing framework for allocation of securities and specialist performance evaluation.

²⁵ Thus, the Primary Specialist will be deemed to be the Directed Specialist with all OEW orders.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with section 6(b) of the Act²⁶ in general, and furthers the objectives of section 6(b)(5)²⁷ in particular, in that it is 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; and is not designed to permit unfair discrimination between customers, issuers, brokers or dealers. Specifically, the proposed rule change will permit member firms to direct order flow to the specialist of their choice and promotes competition to provide the best market.

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

The Phlx 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 Phlx has neither solicited nor received written comments with respect to 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 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 Section. 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-2001-98 and should be submitted by December 4, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁸

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 01-28272 Filed 11-9-01; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45014; File No. SR-Phlx-2001-98]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 by the Philadelphia Stock Exchange, Inc. Relating to Remote Specialists

November 2, 2001.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934¹ ("Act"), and Rule 19b-4 thereunder,² notice is hereby given that on October 22, 2001, 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 Phlx. The Phlx submitted to the Commission Amendment No. 1 on November 1, 2001. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

²⁸ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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

Phlx proposes to establish a remote specialist program. Specifically, the Exchange proposes to adopt new Phlx Rule 461, PACE Remote Specialists. The text of the proposed rule is set forth in full below.

Rule 461 PACE Remote Specialist

PACE terminals and related equipment will be provided to member organizations for trading by remote specialists. The terminals will be linked to the PACT Trading System and will provide the same functionality as is available to on-floor specialists. All orders to remove specialists, including ITS commitments and administrative messages, will be processed the same as orders and ITS Commitments to an on-floor specialist. Floor Broker orders will be routed to remote specialists under the same criteria by which they are routed to on-floor specialists. There will be no remote floor brokerage services. The following shall apply to remote specialists:

(a) All rules and policies of the Board of Governors of the Exchange shall apply except as specifically excluded or amended under this section.

(b) Any specialist unit approved pursuant to Rule 501 may apply to the Equity Allocation, Evaluation and Securities Committee (the "EAES Committee") to trade as a remote specialist, pursuant to this Rule and Rule 511(b).

(c) Unless the EAES Committee specifically authorizes otherwise, participating specialist units shall be prohibited from trading remotely any securities which are currently being traded on-floor by that specialist unit. Individual securities may not be traded by one specialist unit in more than one Phlx remote location under any circumstances.

(d) The number and identity of specialty securities that may be traded remotely by any specialist unit shall be determined by the EAES Committee on a case by case basis.

(e) All non-electronic layoff orders entered on another exchange shall be recorded and submitted to the Exchange pursuant to Exchange procedures.

(f) All rule, by-law and Certificate of Incorporation references pertaining to the trading floor of the Exchange shall be deemed to include any bids, offers, orders and trading done remotely, and all such bids, offers, orders and trades shall be deemed to be Phlx bids, offers, orders and executions on the Exchange.

(g) A written confidentiality policy regarding the location of equipment and

²⁶ 15 U.S.C. 78f(b).

²⁷ 15 U.S.C. 78f(b)(5).