

midpoint of the NBBO. When a locked or crossed market exists in the security, the inbound Directed Order would bypass the Directed Order Process<sup>6</sup> and immediately enter the Display Order Process for execution.<sup>7</sup> In the Directed Order Process, the User's Directed Order would be executed against a Directed Fill, which is the order of the User's designated market maker. Specifically, for a market maker to interact with incoming Directed Orders, the market maker must submit a standing instruction to ArcaEx for the parameters of a Directed Fill, including, but not limited to, the size of the order, the Users who may send such market maker a Directed Order, the price improvement algorithm and the period of time the instruction is effective. The proposed Midpoint Directed Fill would be an additional feature of the ArcaEx system's price improvement algorithm, which would enable market makers to match automatically against incoming Directed Orders at the midpoint price between the NBBO.

The Exchange's current minimum price variation for securities traded on the ArcaEx is \$0.01. The minimum price improvement increment ("MPII") on ArcaEx is equal to \$0.01 or ten percent of the NBBO spread, whichever is greater.<sup>8</sup> Under the proposal, Midpoint Cross Orders and Midpoint Directed Fills could receive executions at price increments finer than the minimum trading differential currently permitted under the Exchange's rules. In order to implement these new order types, the Exchange proposes to add interpretive language to address situations where the midpoint of the NBBO bid/ask differential is a subpenny price (e.g., the midpoint of an NBBO of \$20—\$20.03 is \$20.015). In such circumstances, the proposed rule would permit Midpoint Cross Orders and Midpoint Directed Fills to be executed and reported in increments as small as one-half of the

minimum price variation (i.e., as \$0.005).<sup>9</sup> Furthermore, in situations where the NBBO bid/ask differential is one minimum price variation (i.e., \$0.01), Midpoint Cross Orders and Midpoint Directed Fills may be executed in increments of one-half of the minimum price variation (i.e., as \$0.005), as an exception to the current MPII. In addition, the Exchange proposes minor technical changes to eliminate obsolete references and to change the text so that Rule 7.6(a), Commentary .05 would conform to Rule 7.6(a), Commentary .03.

### III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange<sup>10</sup> and, in particular, the requirements of Section 6 of the Act.<sup>11</sup> Further, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,<sup>12</sup> in that the rules have been designed to remove impediments to and to perfect the mechanism of a free and open market and a national market system, while also protecting investors and the public interest.

### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>13</sup> that the proposed rule change (File No. SR-PCX-2002-53), is hereby approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>14</sup>

**J. Lynn Taylor,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47065; File No. SR-PCX-2002-72]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Pacific Exchange, Inc. Relating to Changes in Marketing Fees

December 20, 2002.

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 November 25, 2002, the Pacific Exchange, Inc. ("PCX") 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 PCX. 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 PCX is proposing to change its marketing fee for certain options and to adopt new marketing fees for recently listed options. The text of the proposed change is available at the PCX 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 PCX 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 PCX 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

###### Purpose

The PCX recently adopted a payment-for-order-flow program under which it charges a marketing fee ranging from \$0 to \$1.00 per contract on a per-issue basis.<sup>3</sup> The PCX segregates the funds from this fee by trading post and makes

<sup>6</sup> The Directed Order Process is the first step in the ArcaEx execution algorithm. Through this Process, Users may direct an order to a Market Maker with whom that they have a relationship and the Market Maker may execute the order. To access this process, the User must submit a Directed Order, which is a market or limit order to buy or sell that has been directed to the a particular market maker by the User. See PCXE Rule 7.37(a) (description of "Directed Order Process").

<sup>7</sup> The Display Order Process is the second step in the ArcaEx execution algorithm. In this process, the ArcaEx system matches an incoming marketable order against orders in the Display Order Process at the display price of the resident order for the total size available at the that price or for the size of the incoming order. See PCXE Rule 7.37(b) (description of "Display Order Process").

<sup>8</sup> See PCXE Rule 7.6(a), Commentary .06. Under current PCXE rules, the MPII requirements must be satisfied in the execution of Cross Orders and Directed Orders. See PCXE Rules 7.31(j) and (s).

<sup>9</sup> See proposed PCXE Rule 7.6(a), Commentary .07.

<sup>10</sup> The Commission has considered the proposal's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

<sup>11</sup> 15 U.S.C. 78f.

<sup>12</sup> 15 U.S.C. 78f(b)(5).

<sup>13</sup> *Id.*

<sup>14</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> See Securities Exchange Act Release No. 44830 (September 21, 2001), 66 FR 49728 (September 28, 2001) (SR-PCX-2001-37).

the funds available to LMMs for their use in attracting orders in the options traded at the posts. The PCX charges the marketing fees as set forth in the Schedule of Rates.

The PCX is proposing to change the marketing fee for certain options as set forth in the Schedule of Rates beginning at the commencement of the December trade month and continuing until further notice. The PCX proposes to change only the amounts of the fees that it charges for transactions in the options that are included in the proposed Schedule of Rates. Any fees currently being charged for transactions in options that are not listed in this change to the Schedule of Rates would not be affected by the proposed rule change. The PCX believes that its proposed rule change is reasonable and equitable because it is designed to enable the PCX to compete with other markets in attracting options business. Only the amount of the fee is being changed.

#### Basis

The PCX believes that the proposal is consistent with Section 6(b) of the Act,<sup>4</sup> particularly Section 6(b)(4) of the Act,<sup>5</sup> in that it provides for the equitable allocation of reasonable dues, fees and other charges among its members.

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

The PCX 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 PCX 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

The foregoing rule change has become immediately effective pursuant to Section 19(b)(3)(A) of the Act<sup>6</sup> and Rule 19b-4(f) thereunder<sup>7</sup> because it changes the PCX fee schedule. At any time within 60 days after the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears 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 proposal 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 PCX. All submissions should refer to File No. SR-PCX-2002-72 and should be submitted by January 17, 2003.

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. 34-47059; File No. SR-Phlx-2002-11]

### Self-Regulatory Organizations; Order Approving a Proposed Rule Change and Amendment No. 1 Thereto by the Philadelphia Stock Exchange, Inc. Proposing To Amend Phlx Rule 201A(b), Alternate Specialist Assignment

December 20, 2002.

#### I. Introduction

On February 11, 2002, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and

Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend Phlx Rule 201A(b), Alternate Specialist Assignment, to delete restrictions on members, member organizations and persons affiliated with member organizations from acting as an alternate specialist while that member, member organization or person affiliated with member organization is either a specialist in the options overlying the equity issue or a Registered Options Trader ("ROT") with an assignment in the overlying options. The Exchange filed Amendment No. 1 to the proposed rule change on September 10, 2002.<sup>3</sup> The proposed rule change, as amended, was published for comment in the **Federal Register** on November 7, 2002.<sup>4</sup> The Commission received no comment letters on the proposed rule change. This order approves the proposed rule change, as amended.

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>5</sup> In particular, the Commission finds that the proposed rule change to eliminate the restriction on an alternate specialist being affiliated with a specialist or ROT in the overlying option is consistent with Section 6(b)(5) of the Act,<sup>6</sup> which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade and to remove impediments to and perfect the mechanism of a free and open market.

The Exchange's rules do not restrict a Phlx primary equity specialist from being affiliated with a specialist or ROT trade in the overlying option. The Commission does not believe that such a restriction is necessary for alternate specialists. The Commission also believes that the potential for manipulative or other improper trading activity is minimized by the physical separation of the Exchange's options and equity trading floors. Further, the Commission notes that the Exchange's Market Surveillance and Examinations Departments will continue to monitor and surveil for improper trading activity.

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

<sup>3</sup> On September 10, 2002, the Exchange filed a Form 19b-4, which replaced the original filing in its entirety ("Amendment No. 1").

<sup>4</sup> See Securities Exchange Act Release No. 46758 (October 31, 2002), 67 FR 67885.

<sup>5</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>6</sup> 15 U.S.C. 78f(b)(5).

<sup>4</sup> 15 U.S.C. 78f(b).

<sup>5</sup> 15 U.S.C. 78f(b)(4).

<sup>6</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>7</sup> 17 CFR 240.19b-4.

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

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