

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 NASD. All submissions should refer to File No. SR-NASD-2003-139 and should be submitted by November 13, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48640; File No. SR-PCX-2003-47]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto by the Pacific Exchange, Inc. Relating to the Manner in Which a Contrary Exercise Advice Is Submitted and To Extend by One Hour the Time for Members To Submit Contrary Exercise Advices

October 16, 2003.

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 September 11, 2003, the Pacific Exchange, Inc. ("PCX" or "Exchange") submitted to 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 Exchange amended its proposal on September 22, 2003.<sup>3</sup> The proposal was

also amended by the Exchange on October 10, 2003.<sup>4</sup> The Exchange filed the proposed rule change, as amended, under paragraph (f)(6) of Rule 19b-4 under the Act.<sup>5</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange proposes to amend PCX Rule 6.24 regarding the manner in which a contrary exercise advice ("CEA") is submitted to the Exchange and to extend by one hour the time for Members and Member Organizations to submit CEAs to the Exchange. Below is the text of the proposed rule change, as amended. Proposed new language is *italicized*; proposed deleted text is [bracketed].

\* \* \* \* \*

Rule 6.24. (a) [Subject to the restrictions set forth in Rule 6.9 and to such restrictions as may be imposed pursuant to Rule 6.11 or pursuant to the Rules of the Options Clearing Corporation ("OCC"), an outstanding option contract may be exercised during the time period specified in the Rules of the OCC by the tender to the OCC of an exercise notice in accordance with the Rules of the OCC.] *An outstanding option contract may be exercised by the tender to the Options Clearing Corporation ("OCC") of an exercise notice made during the periods, and using the procedures, specified in OCC rules. An exercise notice may be tendered to the OCC only by the clearing member in whose account such option contract is carried with the OCC. Option exercises are also subject to restrictions that are established by or may be imposed by the Exchange in Rules 6.9, 6.11 and in this rule. Members and Member Organizations may establish fixed procedures as to the latest time they will accept exercise instructions from customers.*

(b) [The exercise cut-off time for all non-cash settled options shall be such hour on the business day immediately prior to the expiration date as may be fixed from time to time by the Exchange. The exercise cut-off time, as so fixed by

thirty-day operative date specified in Rule 19b-4(f)(6) of the Act and changed rule language in proposed PCX Rule 6.24(f) and proposed Commentary .06.

<sup>4</sup> See letter from Mai Sharif Shiver, Senior Attorney, PCX, to Nancy Sanow, Assistant Director, Division, Commission, dated October 9, 2003 ("Amendment No. 2"). In Amendment No. 2, the PCX added language to the rule text that was inadvertently deleted from its original filing.

<sup>5</sup> 17 CFR 240.19b-4(f)(6).

a member organization or as established pursuant to the preceding sentence, shall also apply in respect of option contracts carried in any proprietary account of such member organization as the latest time at which such member organization, if it is a clearing member, shall tender exercise notices to the OCC, or if it is not a clearing member, shall issue exercise instructions to its clearing member. Notwithstanding the foregoing, member organizations may receive and members may submit exercise instructions and tender exercise notices after the exercise cut-off time but prior to expiration (i) in the case of option contracts carried in an account maintained for another member organization in which only positions of customers of such other member organization are carried, (ii) in order to remedy mistakes or errors made in good faith, (iii) to take appropriate action as the result of a failure to reconcile unmatched Exchange transactions, or (iv) where exceptional circumstances relating to a customer's ability to communicate exercise instructions to the member organization (or the member organization's ability to receive exercise instructions) prior to such cut-off time warrant such action. This subparagraph (b) is intended as a means of providing for relatively uniform procedures in respect of exercise instructions and not to alter or affect in any way the expiration times for an option contract which are fixed in accordance with the Rules of the OCC or any other provision of an option contract, and the exercise prior to expiration of an option contract in contravention of this subparagraph (b) shall neither affect the validity of such exercise nor modify or otherwise affect any right or obligation of any holder or writer of any option contract of such series of options. As used herein with respect to any member organization, the word "customer" shall mean every person other than the member organization.] *Special procedures apply to the exercise of equity options on the last business day before their expiration ("expiring options"). Unless waived by OCC, expiring options are subject to the Exercise by Exception ("Ex-by-Ex") procedure under OCC Rule 805. This rule provides that, unless contrary instructions are given, option contracts that are in-the-money by specified amounts shall be automatically exercised. In addition to OCC rules, the following Exchange requirements apply with respect to expiring options. Option holders desiring to exercise or not exercise expiring options must either: (i) take no action and allow exercise*

<sup>13</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 letter from Mai Sharif Shiver, Senior Attorney, PCX, to Nancy Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated September 17, 2003 ("Amendment No. 1"). In Amendment No. 1, the PCX requested that the Commission waive the

determinations to be made in accordance with OCC's Ex-by-Ex procedures where applicable; or (ii) submit a "Contrary Exercise Advice" to the Exchange by the deadline specified in paragraph (c) below. A Contrary Exercise Advice is a communication either (A) to not exercise an option that would be automatically exercised under OCC's Ex-by-Ex procedure, or (B) to exercise an option that would not be automatically exercised under OCC's Ex-by-Ex procedure. A Contrary Exercise Advice may be submitted by a Member or Member Organization by using the Exchange's Contrary Exercise Advice Form, OCC's ENCORE System, a Contrary Exercise Advice form of any other national securities exchange of which the firm is a Member and where the option is listed, or such other method as the Exchange may prescribe. A Contrary Exercise Advice may be canceled by filing an "Advice Cancel" with the Exchange or resubmitted at any time up to the submission cut-off times specified below.

(c) Exercise cut-off time. Option holders have until 2:30 p.m. (PST) on the business day immediately prior to the expiration date to make a final decision to exercise or not exercise an expiring option. For customer accounts, Members and Member Organizations may not accept exercise instructions after 2:30 p.m. (PST) but have until 3:30 p.m. (PST) to submit a Contrary Exercise Advice. For non-customer accounts, Members and Member Organizations may not accept exercise instructions after 2:30 p.m. (PST) but have until 3:30 p.m. (PST) to submit a Contrary Exercise Advice if such Member or Member Organization employs an electronic submission procedure with time stamp for the submission of exercise instructions by option holders. Consistent with Commentary .04, Members and Member Organizations are required to submit a Contrary Exercise Advice by 2:30 p.m. (PST) for non-customer accounts if such Members and/or Member Organization do not employ an electronic submission procedure with time stamp for the submission of exercise instructions by option holders.

(d) If OCC has waived the Ex-by-Ex procedure for an options class, Members and Member Organizations must either:

- (i) submit to the Exchange, a Contrary Exercise Advice, in a manner specified by the Exchange, within the time limits specified in paragraph (c) above if the holder intends to exercise the option, or
- (ii) take no action and allow the option to expire without being exercised.

The applicable underlying security price in such instances will be as described in OCC Rule 805(j). In cases where the Ex-by-Ex procedure has been waived, OCC rules require that Members and Member Organizations wishing to exercise such options must submit an affirmative Exercise Notice to OCC, whether or not a Contrary Exercise Advice has been filed with the Exchange.

(e) An Exchange Member Organization that has accepted the responsibility to indicate final exercise decisions on behalf of another Member or non-Member firm shall take the necessary steps to ensure that such decisions are properly indicated to the Exchange. Such Member Organization may establish a processing cut-off time prior to the Exchange's exercise cut-off time at which it will no longer accept final exercise decisions in expiring options from option holders for whom it indicates final exercise decisions. Each Member or Member Organization that indicates final exercise decisions through another broker-dealer is responsible for ensuring that final exercise decisions for all of its proprietary (including market maker) and public customer account positions are indicated in a timely manner to such broker-dealer.

(f) Members and Member Organizations may receive and submit final exercise decisions after the exercise cut-off time but prior to expiration without having submitted a Contrary Exercise Advice: (i) In order to remedy mistakes made in good faith; (ii) to take appropriate action as the result of a failure to reconcile unmatched Exchange option transactions; or (iii) where exceptional circumstances have restricted an option holder's ability to inform a Member organization of a decision regarding exercise, or a Member organization's ability to receive an option holder's decision by the cut-off time. The burden of establishing any of the above exceptions rests solely on the Member or Member Organization seeking to rely on such exceptions.

(g) In the event the Exchange provides advance notice on or before 2:30 p.m. (PST) on the business day immediately prior to the last business day before the expiration date indicating that a modified time for the close of trading in equity options on such last business day before expiration will occur, then the deadline to make a final decision to exercise or not exercise an expiring option shall be 1 hour 28 minutes following the time announced for the close of trading on that day instead of the 2:30 p.m. (PST) deadline found in Rule 6.24(c). However, Members and Member Organizations may deliver a

Contrary Exercise Advice or Advice Cancel to the Exchange within 2 hours 28 minutes following the time announced for the close of trading in equity options on that day instead of the 3:30 p.m. (PST) deadline found in Rule 6.24(c) for customer accounts and non-customer accounts where such Member firm employs an electronic submission procedure with time stamp for the submission of exercise instructions. For non-customer accounts, Members and Member Organizations that do not employ an electronic procedure with time stamp for the submission of exercise instructions are required to deliver a Contrary Exercise Advice or Advice Cancel within 1 hour and 28 minutes following the time announced for the close of trading on that day instead of the 2:30 p.m. (PST) deadline found in Rule 6.24(c).

(h)(1) The Exchange may establish extended cut-off times for decision to exercise or not exercise an expiring option and for the submission of Contrary Exercise Advices on a case by case basis due to unusual circumstances.

(2) The Exchange with at least one (1) business day prior advance notice, by 9 a.m. (PST) on such day, may establish a reduced cut-off time for the decision to exercise or not exercise an expiring option and for the submission of Contrary Exercise Advices on a case-by-case basis due to unusual circumstances; provided, however, that under no circumstances should the exercise cut-off time and the time for submission of a Contrary Exercise Advice be before the close of trading.

#### Commentary

[.01 The exercise cut-off time pursuant to Rule 6.24(b) for option contracts shall be 2:30 P.M. (PT) on the business day immediately prior to the expiration date. In the event a member organization does not carry accounts for customers, it shall nevertheless be subject to such exercise cut-off time for the purposes of the third and fourth sentences of Rule 6.24(b).

.02 Each member organization shall prepare a memorandum of every exercise instruction received from a customer showing the time when such instruction was so received. Such memoranda shall be subject to the requirements of SEC Rules 17a-3(a)(6) and 17a-4(b).

.03 In the event a member submits an exercise instruction or tenders an exercise notice pursuant to an exception set forth in clause (ii), (iii) or (iv) of Rule 6.24(b), the member shall maintain a memorandum setting forth the circumstances giving rise to such

exception. If the member is relying on clause (ii) or clause (iv) as the basis of an exception, it shall promptly file a copy of the memorandum with the Exchange.

.04 Clearing Members must follow the procedures of the OCC when exercising expiring non-cash settled equity option contracts. Members must also follow the procedures set forth below with respect to the exercising of non-cash settled equity option contracts that would otherwise not be exercised, or the non-exercising of option contracts that otherwise would be exercised by operation of the OCC Rule 805.

(a) For all such contracts exercised or not exercised, a "contrary exercise advice" must be delivered by the member in such form or manner prescribed by the Exchange to a place designated by the Exchange no later than 2:30 p.m. (PT) on the business day immediately prior to the expiration date;

(b) Subsequent to the delivery of a "contrary exercise advice," should the Market Maker, Floor Broker, customer or firm determine to act other than as reflected on the original advice form, the Member must also deliver an "advice cancel" in such form or manner prescribed by the Exchange to a place designated by the Exchange no later than 2:30 p.m. (PT) on the business day immediately prior to the expiration date;

(c) The preparation, time stamping or submission of a "contrary exercise advice" prior to the purchase of the contracts to be exercised or not exercised shall be deemed a violation of this Rule.

(d) All of the foregoing provisions of this Commentary .04 are in full force and effect whether or not the OCC waives the exercise-by-exception provisions of its Rule 805; in the event of such waiver, the procedures of this Commentary shall be followed as if such provisions of OCC Rule 805 were in full force and effect; and OCC rules may require the submission of an affirmative exercise notice even in circumstances where a contrary exercise advice is not required; and

(e) The failure of any Member to follow the provisions in this Commentary .04 may be referred to the Ethics and Business Conduct Committee and result in the assessment of a fine, which may include but is not limited to disgorgement of potential economic gain obtained or loss avoided by the subject exercise, as determined by the Committee.

.05 Members and member organizations shall properly communicate final exercise decisions to

the Exchange in respect of positions for which they are responsible. Member organizations may establish a processing cut-off time prior to the Exchange's exercise cut-off time at which it will no longer accept final exercise decisions in expiring options for customers.

.06 Submitting or preparing an exercise instruction after the exercise cut-off time in any expiring option on the basis of material information released after the cut-off time is actively inconsistent with just and equitable principals of trade.]

.01 For purposes of this Rule 6.24, the terms "customer account" and "non-customer account" have the same meaning as defined in OCC By-Laws Article I(C)(28) and Article I (N)(2), respectively.

.02 Each Member Organization shall prepare a memorandum of every exercise instruction received showing the time when such instruction was received. Such memoranda shall be subject to the requirements of SEC Rule 17a-4(b).

.03 In the event of an "unusual circumstance," Rule 6.24(h)(1) provides that the Exchange may extend the cut-off times for exercise instructions and the submission of a Contrary Exercise Advice beyond the normal time frames specified in Rule 6.24(c). For purposes of subparagraph (h)(1), an "unusual circumstance" includes, but is not limited to, increased market volatility; significant order imbalances; significant volume surges and/or systems capacity constraints; significant spreads between the bid and offer in underlying securities; internal system malfunctions affecting the ability to disseminate or update market quotes and/or deliver orders; or other similar occurrences. Rule 6.24(h)(2) specifies that the Exchange may also reduce such cut-off times for "unusual circumstances." For purposes of subparagraph (h)(2), an "unusual circumstance" includes, but is not limited to, a significant news announcement concerning the underlying security of an option contract that is scheduled to be released just after the close on the business day immediately prior to expiration.

.04 Although the deadline for all option holders to make a final decision to exercise or not exercise is 2:30 p.m. (PST), the deadline for the submission of the Contrary Exercise Advice in the case of non-customer accounts will depend on the manner of the decision to exercise or not exercise.

(i) For electronic timestamp submissions of the exercise decision by non-customer option holders, a Contrary Exercise Advice submitted by Members and Member Organizations

must be received by the Exchange by 3:30 p.m. (PST).

(ii) For manual submissions of the exercise decision by non-customer option holders, Members and Member Organizations must submit a Contrary Exercise Advice at the Exchange via the Contrary Exercise Advice Box by 2:30 p.m. (PST).

.05 Each Member Organization shall establish fixed procedures to insure secure time stamps in connection with their electronic systems employed for the recording of submissions to exercise or not exercise expiring options.

.06 In the event a Member or Member Organization receives and submits a final exercise decision after the exercise cut-off time pursuant to an exception set forth in clauses (i), (ii) or (iii) of paragraph (f) of Rule 6.24, the Member or Member Organization shall maintain a memorandum setting forth the circumstances regarding such exception and shall file a copy of the memorandum with the Exchange's Market Surveillance Department no later than 9 a.m. on the first business day following the respective expiration.

.07 The filing of a Contrary Exercise Advice required by this rule does not serve to substitute as the effective notice to OCC for the exercise or non-exercise of expiring options.

.08 The failure of any Member to follow the provisions in this Rule may be referred to the Ethics and Business Conduct Committee and result in the assessment of a fine, which may include but is not limited to disgorgement of potential economic gain obtained or loss avoided by the subject exercise, as determined by the Committee.

.09 Submitting or preparing an exercise instruction after the exercise cut-off time in any expiring option on the basis of material information released after the cut-off time is actively inconsistent with just and equitable principals of trade.

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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 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, as amended. The text of these statements may be examined at the places specified in Item IV below and is 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 Options Clearing Corporation ("OCC"), the issuer of all PCX-traded options contracts, has an established procedure for options holders wishing to automatically exercise in-the-money options<sup>6</sup> before they expire. Known as Exercise by Exception or "Ex-by-Ex", the procedure provides for the automatic exercise at expiration of any equity option contract that is 3/4 of a point or more in-the-money for customer accounts or 1/4 point or more in-the-money for any other accounts.<sup>7</sup> Option holders who wish to have their contracts exercised in accordance with the Ex-by-Ex procedure do not need to take any further action; the contracts that are in-the-money by the appropriate amount will be automatically exercised. Option holders who do not wish to have their options automatically exercised, or who wish their options to be exercised under different parameters than the Ex-by-Ex procedure, must file a CEA with the Exchange pursuant to PCX Rule 6.24, and instruct OCC of their "contrary intention".<sup>8</sup> The Exchange believes that PCX Rule 6.24 is designed to deter individuals from taking improper advantage of late-breaking news by requiring evidence of an option holder's intention regarding whether to exercise an expiring equity option via the submission of a CEA. Members and Member Organizations satisfy the filing requirement by manually submitting a CEA or by electronically submitting the CEA through OCC's ENCORE system.

The Exchange states that the principal goal of PCX Rule 6.24 is to maintain a level playing field between persons holding long and short positions in expiring equity options. The PCX believes that after trading has ended on the final trading day before expiration, persons who are short in the option have no way to close out their short position. To put option holders on equal footing, PCX Rule 6.24 attempts to minimize the time period in which a holder can exercise the equity option after the close of trading on the last business day prior to expiration,

<sup>6</sup> "In-the-money" for a call option occurs if the current market value of the underlying security is above the exercise price of the option. For put options, "in-the-money" means the current value of the underlying security is below the exercise price of the option.

<sup>7</sup> See OCC Rule 805(d).

<sup>8</sup> A CEA may be canceled by filing an "Advice Cancel" with the Exchange at any time up to the submission cut-off deadline specified in proposed amended PCX Rule 6.24.

generally known as "Expiration Friday."<sup>9</sup>

The current exercise cut-off time for an option holder to decide whether to exercise an equity option is 2:30 p.m. (PST) on the business day immediately prior to the expiration date.<sup>10</sup> Under the proposal, the exercise cut-off time set forth in amended PCX Rule 6.24(c) will not change except in cases of a modified trading session or due to "unusual circumstances." Current PCX Rule 6.24 imposes a uniform 2:30 p.m. cut-off time for the submission of CEAs for all accounts without differentiating between customer and non-customer accounts.

The Exchange states that the proposed rule change was prompted by concerns expressed by clearing firms that the deadline for submitting CEAs is problematic for customer accounts,<sup>11</sup> due to the logistical difficulties of receiving customer exercise instructions and processing them through their retail branch systems and back office areas before submitting them to the Exchange. Therefore, the Exchange proposes to adopt a cut-off time of 3:30 p.m. (PST) for Members and Member Organizations to submit CEAs for customer accounts. The Exchange also proposes to allow Members and Member Organizations to submit CEAs for non-customer accounts<sup>12</sup> by 3:30 p.m. (PST) provided such Member or Member Organization employs an electronic procedure with time stamp recording for the submission of exercise instructions by options holders. In those cases where Members or Member Organizations do not employ an electronic submission procedure for the submission of exercise instructions, CEAs for non-customer accounts must be submitted to the Exchange by 2:30 p.m. (PST). The different CEA submission deadlines are set forth in amended PCX Rule 6.24(c) and new Commentary .04.

<sup>9</sup> "Expiration Friday" is generally the last business day prior to the expiration of an option contract.

<sup>10</sup> The "expiration date" of an options contract generally is the Saturday immediately following the third Friday of the expiration month of such option. See OCC By-Laws Article I (E)(16).

<sup>11</sup> A "customer account" is defined in OCC By-Laws Article I (C)(28) as an account of a Clearing Member which is confined to Exchange transactions cleared and positions carried by the Clearing Member on behalf of its securities customers, other than those transactions of market-makers which are cleared through a market-makers account. OCC By-Laws define a "securities customer" as a person having a securities account at a broker or dealer other than a non-customer of such broker or dealer. See OCC By-Laws Article I (S)(1).

<sup>12</sup> A "non-customer account" generally means a person that is not a customer of a broker or dealer defined in Rule 8c-1 and 15c2-1 under the Act. See OCC By-Laws Article I (N)(2).

Although many Members and Member Organizations have electronic submission procedures, the Exchange is concerned that those firms that manually submit CEAs could have an opportunity to improperly extend the 2:30 p.m. (PST) deadline for option holders to submit their exercise instructions. This concern on the part of the Exchange is based on the difficulty in monitoring a manual procedure that has different times for deciding whether to exercise an option and to submit a CEA.

Accordingly, in the case of non-customer accounts, the Exchange has proposed to limit the 3:30 p.m. (PST) deadline for submitting CEAs to those Members and Member Organizations that have an electronic submission procedure for option holders communicating their decisions whether to exercise an option. In connection with the use of an electronic submission procedure by Members and Member Organizations, the Exchange proposes the addition of new Commentary .05 to PCX Rule 6.24 to require Members and Member Organizations employing electronic submissions to establish procedures to secure time stamps in connection with their electronic systems.

OCC on occasion will suspend the use of its Ex-by-Ex procedure, such as when trading in the underlying stock has been halted or if accurate price data is unavailable for the determination of closing prices. When this occurs and there is no automatic exercise, all options contract holders must send an exercise notice to OCC if they wish to exercise an option, regardless of whether the option is in or out-of-the-money. Currently, when OCC suspends its Ex-by-Ex procedure for an option class, PCX Rule 6.24 requires the submission of a CEA. Thus, when OCC has waived the Ex-by-Ex procedure, option holders must determine what price would have been used, even though the only available price might be a stale last sale price (a price OCC did not feel comfortable using). Option holders then must determine whether a CEA needs to be submitted to the Exchange evidencing the intention to exercise or not exercise.

In the PCX's view, the options exchanges have long viewed this process as cumbersome and confusing to option holders. Therefore, the PCX proposes to amend PCX Rule 6.24(d) to eliminate the requirement that a CEA be submitted if the holder does not want to exercise the option when OCC has suspended its Ex-by-Ex procedure for that options class. As a result, when the Ex-by-Ex procedure has been

suspended, submission of CEAs to the Exchange will be required only when the options holder wants to exercise the option contract.

The proposed rule change would also permit the Exchange to establish different cut-off times as an exception to amended PCX Rule 6.24(c) to address situations where the Exchange has advance prior knowledge or warning of a modified trading session at expiration, or in the case of "unusual circumstances."

Specifically, proposed PCX Rule 6.24(g) would apply when a different or modified close of trading is announced due to a market-wide event. In such cases, the Exchange would have forewarning of the event and would be required to provide notice of a change in cut-off times by 2:30 p.m. (PST) on the business day prior to the last trading day before expiration. For example, if the day after Thanksgiving is the last trading day prior to expiration with a close of trading of 10 a.m. (PST), then the Exchange would, with prior notice by 2:30 p.m. (PST) on the Wednesday before Thanksgiving, be able to establish the cut-off time for option holders to decide whether to exercise expiring options to 1 hour 28 minutes after the close of trading. With respect to the submission of CEAs by Members and Member Organizations, the cut-off time would be 2 hours and 28 minutes after the close of trading for customer accounts and non-customer accounts where the Members and Member Organizations employ an electronic procedure with time stamp for the submission of exercise instructions. Members and Member Organizations that do not employ an electronic submission procedure for exercise instructions would be required to submit a CEA within 1 hour and 28 minutes after the close of trading for its non-customer accounts. Accordingly, the normal exercise cut-off times would not apply and, similar to amended PCX Rule 6.24(c), the deadline for submitting CEAs to the Exchange for non-customer accounts would depend on the use of an electronic submission procedure for the submission of exercise instructions.

Proposed PCX Rule 6.24(h)(1) would permit the Exchange to extend the cut-off time periods for option holders to decide whether to exercise expiring options, as well as for Members to submit CEAs due to unusual circumstances. Situations that are deemed to be an "unusual circumstance" are set forth in revised Commentary .03 to PCX Rule 6.24. An "unusual circumstance" for purposes of proposed paragraph (h)(1) includes, but is not limited to, increased market

volatility; significant order imbalances; significant volume surges and/or systems capacity constraints; significant spreads between the bid and offer in underlying securities; internal system malfunctions affecting the ability to disseminate or update market quotes and/or deliver orders; or other similar occurrences.

Proposed PCX Rule 6.24(h)(2) would permit the Exchange, with one (1) business day prior advance notice by 9 a.m. (PST), to establish a reduced cut-off time for option holders to decide whether to exercise expiring options as well as for Members to submit CEAs. The reduced cut-off time under this new paragraph for both exercise decisions and CEA submissions may not occur before the close of trading. The primary purpose of proposed paragraph (h)(2) is to permit the Exchange to reduce cut-off times because of an "unusual circumstance," such as a significant news event occurring after the close. Revised Commentary .03 to PCX Rule 6.24 provides that, for purposes of subparagraph (h)(2), an "unusual circumstance" is a significant news announcement concerning the underlying security of an option contract that is scheduled to be released after the close on the last trading day prior to expiration. For example, a decision on whether a particular merger will be approved or whether a new product will receive regulatory approval that occurs after the close of trading would justify a reduced cut-off time so that persons holding short positions are not prejudiced by being unable to close out their positions. The Exchange believes that this would maintain a level playing field between persons holding long and short positions in expiring options.

## 2. Statutory Basis

The Exchange believes that the proposed rule change, as amended, is consistent with Section 6(b) of the Act<sup>13</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>14</sup> in particular, because it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

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

<sup>14</sup> 15 U.S.C. 78f(b)(5).

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

The Exchange does not believe that the proposed rule change, as amended, 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

Written comments on the proposed rule change, as amended, were neither solicited nor received.

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

The proposed rule change, as amended, has been filed by the Exchange pursuant to Section 19(b)(3)(A) of the Act<sup>15</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>16</sup> Because the foregoing proposed rule change: (1) Does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for thirty days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>17</sup> and Rule 19b-4(f)(6)<sup>18</sup> thereunder.<sup>19</sup>

A proposed rule change filed under Rule 19b-4(f)(6)<sup>20</sup> normally does not become operative prior to thirty days after the date of filing. However, pursuant to Rule 19b-4(f)(6)(iii), the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest. The PCX has requested that the Commission waive the thirty-day operative date of the proposed rule change due to the Exchange's need to maintain competition and efficiency.

The Commission believes that waiving the thirty-day operative date is consistent with the protection of investors and the public interest.<sup>21</sup>

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

<sup>16</sup> 17 CFR 240.19b-4(f)(6).

<sup>17</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>18</sup> 17 CFR 240.19b-4(f)(6).

<sup>19</sup> As required under Rule 19b-4(f)(6)(iii), the Exchange provided the Commission with written notice of its intent to file the proposed rule change at least five business days prior to the filing date or such shorter period as designated by the Commission.

<sup>20</sup> 17 CFR 240.19b-4(f)(6).

<sup>21</sup> For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on

Accelerating the operative date will allow the PCX to immediately implement rules similar to ones already in place at the American Stock Exchange LLC and the International Securities Exchange, Inc.,<sup>22</sup> and will simplify and clarify the process by which Members and Member Organizations accept exercise decisions from options holders and submit such decisions to the Exchange. For these reasons, the Commission designates the proposed rule change as effective and operative immediately. At any time within 60 days of the filing of the proposed rule change, as amended, the Commission may summarily abrogate such proposed 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.<sup>23</sup>

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as amended, 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-2003-47 and should be submitted by November 13, 2003.

efficiency, competition, and capital formation.15 U.S.C. 78c(f).

<sup>22</sup> See Securities Exchange Act Release No. 47885 (May 16, 2003), 68 FR 28309 (May 23, 2003) (SR-Amex-2001-92) and 48505 (September 17, 2003), 68 FR 55680 (September 26, 2003) (SR-ISE-2003-20).

<sup>23</sup> For purposes of calculating the sixty-day abrogation period, the Commission considers the period to commence on October 9, 2003, the date at which the Exchange filed Amendment No. 2.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>24</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48648; File No. SR-Phlx-2003-37]

### Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. to Delete the Prohibition Against the Delivery of Electronically Generated Orders Via AUTOM

October 16, 2003.

#### I. Introduction

On May 19, 2003, 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 delete Phlx Rule 1080(i) ("Rule"), which prohibits the delivery of electronically generated orders via Phlx's AUTOM system. Notice of the proposed rule change was published for comment in the **Federal Register** on June 11, 2003.<sup>3</sup> The Commission received two comments regarding the proposal—one from Interactive Brokers Group LLC ("IB") supporting the proposal ("IB Letter"), and the other from Susquehanna International Group LLP ("SIG") opposing the proposal ("SIG Letter")<sup>4</sup>. The Phlx submitted a response to the SIG Letter ("Phlx Response").<sup>5</sup>

This order approves the proposed rule change.

#### II. Description of the Proposal

The Exchange is proposing to delete the Rule, which prohibits the delivery of electronically generated orders, *i.e.*, orders that were created and

communicated electronically without manual input,<sup>6</sup> via AUTOM.<sup>7</sup> According to the Exchange, it has enhanced its AUTOM and AUTO-X systems so that the concerns the Rule was intended to address have been minimized. For example, the Exchange modified its Auto-Quote<sup>8</sup> system to enable the Exchange to disseminate a firm quotation size of at least the sum of limit orders at the Exchange's disseminated price.<sup>9</sup> The Exchange has also expanded the order types<sup>10</sup> and delivery sizes<sup>11</sup> eligible for AUTOM delivery and automatic execution via AUTO-X.

#### III. Summary of Comments and Phlx's Response

##### 1. IB Letter

In its letter supporting the proposal, IB urged the Commission to approve the proposal because IB believes the Rule

<sup>6</sup> Specifically, the Rule required order entry to involve manual input such as entering the terms of the order into an order-entry screen or manually selecting a displayed order against which the off-setting order should be sent.

<sup>7</sup> AUTOM is the Exchange's electronic order delivery, routing, execution and reporting system, which provides for the automatic entry and routing of equity option and index option orders to the Exchange trading floor. Orders delivered through AUTOM may be executed manually, and certain orders are eligible for AUTOM's automatic execution feature, AUTO-X. Equity option and index option specialists are required by the Exchange to participate in AUTOM. Option orders entered by Exchange members into AUTOM are routed to the appropriate specialist unit on the Exchange trading floor.

<sup>8</sup> Auto-Quote is the Exchange's electronic options pricing system, which enables specialists to automatically monitor and instantly update quotations.

<sup>9</sup> See Securities Exchange Act Release No. 46325 (August 8, 2002), 67 FR 53376 (August 15, 2002) (SR-Phlx-2002-15).

<sup>10</sup> In October 2002, the Commission permanently approved an Exchange pilot that allowed orders for the account(s) of broker-dealers to be delivered via AUTOM, and to be eligible for automatic execution via AUTO-X. See Securities Exchange Act Release No. 46660 (October 15, 2002), 67 FR 64951 (October 22, 2002) (SR-Phlx-2002-50). The Exchange then adopted rules providing for automatic executions for eligible orders at the Exchange's disseminated size, subject to a minimum and maximum eligible size range to be determined by the specialist, on an issue-by-issue basis. See Securities Exchange Act Release No. 46886 (November 22, 2002), 67 FR 72015 (December 3, 2002) (SR-Phlx-2002-39). Most recently, the Exchange adopted rules providing an equal firm quotation size and equal AUTO-X guaranteed size for both customer and broker-dealer orders. See Securities Exchange Act Release No. 47646 (April 8, 2003), 68 FR 17976 (April 14, 2003) (SR-Phlx-2003-18).

<sup>11</sup> In March 2003, the Exchange adopted rules to increase the eligible AUTOM order delivery size for off-floor broker-dealer orders from 200 contracts to 1,000 contracts for all options. At the same time, the Exchange determined to allow delivery of Immediate or Cancel orders via AUTOM. See Securities Exchange Act Release No. 47543 (March 20, 2003), 68 FR 14737 (March 26, 2003) (SR-Phlx-2003-11).

<sup>24</sup> 17 CFR 200.30-3(a)(29).

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

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

<sup>3</sup> Securities Exchange Act Release No. 47977 (June 4, 2003), 68 FR 35049.

<sup>4</sup> See letters to Jonathan G. Katz, Secretary, SEC, from David M. Battan, Vice President and General Counsel, IB, dated July 22, 2003; and Gerald D. O'Connell, Director of Compliance, SIG, dated July 9, 2003.

<sup>5</sup> See letter from Richard S. Rudolph, Director and Counsel, Phlx, to Jonathan G. Katz, Secretary, SEC, dated October 6, 2003.