

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

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*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47417; File No. SR-Phlx-2002-61]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment No. 1 Thereto by the Philadelphia Stock Exchange, Inc. To Amend Options Floor Procedure Advice A-13 To Include Violations for Failure To Obtain Approval To Disengage the NBBO Feature in the Exchange's Minor Rule Plan

February 27, 2003.

On October 4, 2002, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend Phlx Option Floor Procedure Advice ("OFPA") A-13, Auto Execution Engagement/Disengagement Responsibility, to include in the Exchange's minor rule violation enforcement and reporting plan ("Minor Rule Plan")<sup>3</sup> violations for failure to obtain the necessary approvals prior to disengagement of the National Best Bid/Best Offer ("NBBO") Feature of the Exchange's Automated Options Market System ("AUTOM").<sup>4</sup> The Exchange's NBBO Feature automatically executes orders at the NBBO for certain options designated by the Phlx's Options Committee as eligible for the NBBO Feature ("automatic step-up options"), provided that the NBBO does not differ

from the specialist's bid or offer by more than the "step up parameter."<sup>5</sup> Currently, engagement and disengagement of the NBBO Feature is governed solely by Phlx Rule 1080(c)(i), and violations are referred to the Business Conduct Committee ("BCC").

The Exchange proposed to amend OFPA A-13 to restate from Phlx Rule 1080(c)(i) the conditions for using the NBBO Feature, including the requirement to obtain approval to disengage the NBBO Feature, and to include a fine schedule for failure to obtain such approval. Specifically, the proposed fine schedule is as follows: First occurrence, \$250; second occurrence, \$500; third occurrence, \$1,000; fourth occurrence and thereafter, sanction discretionary with the BCC. The proposed fine schedule would be implemented on a one-year running basis. The BCC also would have discretion concerning sanctions for any violations should they be deemed egregious by the Exchange's Enforcement Department and referred directly to the BCC pursuant to Exchange Rule 960.2.

On November 7, 2002, the Exchange submitted Amendment No. 1 to the proposed rule change.<sup>6</sup> The proposed rule change, as amended, was published in the **Federal Register** on January 22, 2003.<sup>7</sup> The Commission did not receive any comment letters on the proposed rule change. This order approves the proposed rule change, as amended.

The Commission has carefully reviewed the proposal and 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>8</sup> and, in particular, the requirements of section 6 of the Act<sup>9</sup> and the rules and regulations thereunder. The Commission finds specifically that the proposed rule change is consistent with section 6(b)(6) of the Act<sup>10</sup> in that it provides a procedure whereby member

organizations can be disciplined appropriately in those instances when a rule violation is minor in nature, but a sanction more serious than an admonition letter is appropriate. Additionally, the Commission finds that the proposed rule change is consistent with the requirements of sections 6(b)(7)<sup>11</sup> and 6(d)(1)<sup>12</sup> of the Act. Section 6(b)(7) requires the rules of an exchange to be in accordance with the provisions of section 6(d) of the Act, and, in general, to provide a fair procedure for the disciplining of members and persons associated with members. Section 6(d)(1) requires an exchange to bring specific charges, notify such member or person of, and give him an opportunity to defend against, such charges, and keep a record, in any proceeding to determine whether a member or person associated with a member should be disciplined. Finally, the Commission finds the proposal is consistent with Rule 19d-1(c)(2) under the Act,<sup>13</sup> which governs minor rule violations plans.

In approving this proposal, the Commission in no way minimizes the importance of compliance with these rules, and all other rules subject to the imposition of fines under the Exchange's Minor Rule Plan. The Commission believes that the violation of any self-regulatory organization's rules, as well as Commission rules, is a serious matter. However, in an effort to provide the Exchange with greater flexibility in addressing certain violations, the Exchange's Minor Rule Plan provides a reasonable means to address rule violations that do not rise to the level of requiring formal disciplinary proceedings. The Commission expects that the Phlx will continue to conduct surveillance with due diligence, and make a determination based on its findings whether fines of more or less than the recommended amount are appropriate for violations of rules under the Exchange's Minor Rule Plan, on a case by case basis, or if a violation requires formal disciplinary action.

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>14</sup> that the proposed rule change (SR-Phlx-2002-61), as amended, is approved.

<sup>24</sup> 17 CFR 200.30-3(a)(75).

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

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

<sup>3</sup> The Exchange's Minor Rule Plan, codified in Exchange Rule 970, includes Floor Procedure Advices with accompanying fine schedules.

<sup>4</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, or 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 and its features and enhancements. Option orders entered by Exchange members into AUTOM are routed to the appropriate specialist unit on the Exchange trading floor.

<sup>5</sup> For a complete description of the NBBO Feature, see Securities Exchange Act Release No. 43684 (December 6, 2000), 65 FR 78237 (December 14, 2000) (order partially approving SR-Phlx-00-93).

<sup>6</sup> See letter from Rick Rudolph, Director and Counsel, Phlx, to Jennifer Lewis, Commission, dated November 6, 2002 ("Amendment No. 1"). In Amendment No. 1, Phlx fixed nonsubstantive typographical errors in its rule text, and added a cross-reference to Phlx Rule 960.2 in the purpose section of its proposal.

<sup>7</sup> See Securities Exchange Act Release No. 47166 (January 10, 2003), 68 FR 3077.

<sup>8</sup> In approving this proposed rule change, the Commission notes that it has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>9</sup> 15 U.S.C. 78f.

<sup>10</sup> 15 U.S.C. 78f(b)(6).

<sup>11</sup> 15 U.S.C. 78f(b)(7).

<sup>12</sup> 15 U.S.C. 78f(d)(1).

<sup>13</sup> 17 CFR 240.19d-1(c)(2).

<sup>14</sup> 15 U.S.C. 78s(b)(2).