

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**

Phlx proposes to amend various provisions of Phlx rule 1014, "Obligations And Restrictions Applicable To Specialists And Registered Options Traders," and to make conforming changes to Options Floor Procedure Advice ("Advice") B-6 relating to the allocation of trades on the Exchange's Options Floor.

The text of the proposed rule change, as amended, follows.<sup>4</sup> Additions are italicized, and deletions are enclosed in brackets.

\* \* \* \* \*

### **Rule 1014. Obligations and Restrictions Applicable to Specialists and Registered Options Traders**

(a)-(f) No change.

(g) *Equity Option and Index Option Priority and Parity*

(i) (A) Exchange Rules 119 and 120 direct members in the establishment of priority of orders on the floor. In addition, equity option and index option orders of controlled accounts are required to yield priority to customer orders when competing at the same price, as described below.

For the purpose of paragraph (g) of this Rule, "*Initiating Order*" means an incoming contra-side order. "*Remainder of the Order*" means the portion of an Initiating Order that remains following the allocation of contracts to customers that are on parity, in accordance with this Rule 1014(g)(i). The Remainder of the Order shall be allocated pursuant to this Rule 1014. [a] An account type is either a controlled account or a customer account. A controlled account includes any account controlled by or under common control with a broker-dealer. [Specialist accounts of PHLX Option Specialists, however, are not subject to yielding requirements placed upon controlled accounts by this Rule.] Customer accounts are all other accounts.

Orders of controlled accounts must yield priority to customer orders[, except that, PHLX ROTs closing in-person are not required to yield priority to orders of customer accounts].

Orders of controlled accounts are not required to yield priority to other

controlled account orders[, except that when both an order of a PHLX ROT closing in-person and some other order of a controlled account are established in the crowd at the same price, and then a customer order is established at that price, the order of the controlled account must yield to the customer order while the order of the PHLX ROT closing in-person does not have to so yield].

Orders of controlled accounts, other than ROTs and Specialists market making in person, must be (1) verbally communicated as for a controlled account when placed on the floor and when represented to the trading crowd and (2) recorded as for a controlled account by appropriately circling the "yield" field on the floor ticket of any such order.

*Several programs described below provide an Enhanced Specialist Participation to specialists, which refers to the portion of an options trade available for allocation to the specialist on parity, including a 30% (which may actually result in a 40% or 60%) Enhanced Specialist Participation, New Unit/New Option Enhanced Specialist Participation, and New Product Enhanced Specialist Participation.*

*The Enhanced Specialist Participation is a percentage of the Remainder of the Order to which the specialist is entitled, depending upon whether (g)(ii), (iii), or (iv) applies.*

(B) No change.

(ii) *Enhanced Specialist Participation*—In equity and index option classes, when the registered specialist is on parity with a controlled account as defined in subparagraph (i) above, in accordance with Exchange Rules 119 and 120 and the number of contracts to be bought or sold is greater than five, the specialist is entitled to receive an enhanced participation of 30% of the [initiating order] *Remainder of the Order* ("Enhanced Specialist Participation"), except in the following circumstances: (1) where there is one controlled account on parity, the specialist *is entitled to receive*[s] 60% of the [initiating order] *Remainder of the Order*; or (2) where there are two controlled accounts on parity, in which case, the specialist is entitled to *receive* 40% of the [initiating order] *Remainder of the Order*. [Further, no customer order which is on parity may receive a smaller participation than any other crowd participant including the specialist.] *Enhanced Specialist Participation* will be effective for: (a) all newly listed issues, (b) all index options and (c) such issues selected by the specialist and approved by the Allocation, Evaluation and Securities

Committee pursuant to section (A) below.

(A) The Allocation, Evaluation and Securities Committee shall divide each equity and index option specialist's registered issues into trading volume quartiles based upon the most recent quarterly customer contract volume. Each specialist may then select 50% of the issues in each quartile to receive *Enhanced Specialist Participation*, rounded so that no more than 50% of the total number of such specialists' registered issues are selected. The Allocation, Evaluation and Securities Committee shall approve all specialist selections.

(B) Pursuant to Exchange Rule 509, the Allocation, Evaluation and Securities Committee shall reduce the level of *Enhanced Specialist Participation* authorized under this Rule to a parity level of participation in accordance with Rules 119 and 120 with respect to any options class if the specialist in such class is determined to be performing below any minimum standards or not satisfying any conditions that the Exchange may establish with respect to any options class subject to *Enhanced Specialist Participation*. The Committee may reinstate *Enhanced Specialist Participation* for a particular options class if it determines that the specialist in such class is performing at or above all established minimum standards and is satisfying all established conditions.

(C) New specialist units trading new options classes shall *be entitled to* receive an [e]*Enhanced [parity split] Specialist Participation* in accordance with subparagraph (iii) of this Rule. Once the specialist unit is no longer eligible to receive an [e]*Enhanced [parity split] Specialist Participation* in accordance with subparagraph (iii), the unit is automatically entitled to an *Enhanced Specialist [p]Participation* in accordance with this subparagraph (ii).

(iii) *New Unit/New Option Enhanced Specialist Participation*—To encourage the establishment of new specialist units to trade equity and index option classes that heretofore have never been listed on the Exchange ("New Options Classes"), when such units are on parity with controlled accounts in such classes, the new specialist units will be entitled, for a period of six months following commencement of trading in New Option Classes, to the following [e]*Enhanced [s]Specialist [p]Participation* in a any such parity trade: (1) Fifty percent (50%) where there is one controlled account on parity and (2) Forty percent (40%) where there are two or more controlled accounts on parity[, except that no customer order

<sup>4</sup> The proposed changes are set forth below as they would appear in the text of Phlx rule 1014 and in the text of Options Floor Procedure Advice B-6.