

in the Stock Tied Up Order, and thus create a disincentive for the crowd to bid or offer competitively for the remaining 700 option contracts. The Exchange believes that the requirement to present the hedging stock position concurrently with the option order in the crowd and offered to the crowd in its entirety at the stock execution price received by the member organization introducing the order should ensure that the crowd would be competing on a level playing field with the introducing member or member organization to provide the best price to the customer.

In addition, the proposal would require that the hedging stock position not exceed the options order on a delta basis.<sup>6</sup> For example, in the situation where a Stock Tied Up Order involves the simultaneous purchase of 100 shares of XYZ stock and the sale of 1 XYZ call contract (known as a "buy-write"), and the delta of the option is 100, it would be considered "hedged" by 100 shares of stock. Accordingly, the proposed rule would not allow the introducing member firm to purchase more than 100 shares of stock in the hedging stock position. The Exchange believes that it is reasonable to require that the hedging stock position be in amounts equivalent to the size of the related options order on a delta basis, and not for a greater number of shares of stock. The Exchange believes that the proposed rule change would support its view that the member or member organization introducing the Stock Tied Up Order be guided by the notion that any excess hedging activity could be detrimental to the eventual execution price of the customer order. Consequently, while delta estimates may vary slightly, the introducing member or member organization would be required to assume hedging stock positions not to exceed the equivalent size of the options order on a delta basis.

The proposed rule change would also require that the hedging stock order be transacted by the member or member

organization introducing the Stock Tied Up Order promptly upon receipt of the option order, and, if brought to the Exchange, such order would be required to be brought without undue delay to the crowd. The Exchange believes that in many circumstances the member or member organization introducing the Stock Tied Up Order would best serve the interest of the customer by establishing the hedging stock position over a brief period of time, rather than by way of a block-sized market order that could be of high-impact to the stock price. However, the Exchange states that the "prompt" requirement of the proposed rule is intended to ensure that this working period be brief so that the hedging stock position could be brought to the Floor under optimal circumstances for crowd participants to compete most effectively. To accomplish this, the Exchange believes that the hedging stock position must be reasonably related to the price of the option order upon receipt of the option order. In the event a delay does occur and the stock price becomes unattractive as a hedge, the proposed rule would provide that the crowd participants could elect to participate in the option order without participating in the hedging stock position.

Finally, while the particular circumstances surrounding each transaction on the Exchange's options floor are different, the Exchange does not believe, as a general proposition, that the Stock Tied Up Order would be inherently harmful or detrimental to customers. The fact that the parties to such a trade end up fully hedged may contribute to the best execution of the orders, and, in any event, participants continue to be governed by, among other things, their best execution responsibilities.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act<sup>7</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>8</sup> in particular, because 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, by establishing rules governing Stock Tied

Up Orders, which include specific requirements and procedures to be followed prior to and during representation of such orders in the crowd.

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

The Exchange does not believe that the proposed rule change will impose any inappropriate burden on competition.

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

No written comments were solicited or received.

## 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 Exchange 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. In particular, the Commission seeks commenters' specific views on whether the proposed rule change is consistent with the Act. What would be the impact under the proposed rule change of allowing Phlx members to hedge large options orders while avoiding pressures on the market for the underlying securities that can result from the reporting of such options transactions to the tape? Would the proposed rule change violate prohibitions on front running? Should the proposed rule change provide specific standards to determine when a member's hedging stock position does not exceed the options order on a delta basis?

Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Comments may also be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-Phlx-2003-75. This file number

<sup>6</sup> The price of an option is not completely dependent on supply and demand, nor on the price of the underlying security. Specialists and ROTs price options based on basic measures of risk as well. One of these such measures, delta, is the rate of change in the price of an option as it relates to changes in the price of the underlying security. The delta of an option is measured incrementally based on movement in the price of the underlying security. For example, if the price of an option increases or decreases by \$1.00 for each \$1.00 increase or decrease in the price of the underlying security, the option would have a delta of 100. If the price of an option increases or decreases by \$.50 for each \$1.00 increase or decrease in the price of the underlying security, the option would have a delta of 50. See, e.g., Securities Exchange Act Release No. 45575 (March 15, 2002), 67 FR 13395 (March 22, 2002) (SR-Phlx-2001-25).

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

<sup>8</sup> 15 U.S.C. 78f(b)(5).