

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-58361; File No. SR-Phlx-2008-50)

August 14, 2008

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Approving a Proposed Rule Change Relating to the Electronic Handling of Complex Orders

I. Introduction

On July 1, 2008, 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”),¹ and Rule 19b-4 thereunder,² a proposal to adopt Phlx Rule 1080, Commentary .08, “Complex Orders on Phlx XL,” to provide for the electronic handling of certain Complex Orders on Phlx XL, the Phlx’s electronic trading platform for options. The proposed rule change was published for comment in the Federal Register on July 10, 2008.³ The Commission received no comments regarding the proposed rule change. This order approves the proposed rule change.

II. Description of the Proposal

The Phlx proposes to adopt Phlx Rule 1080, Commentary .08 to provide for the electronic handling of certain Complex Orders on Phlx XL.⁴ Phlx members and Phlx XL participants quoting and trading in open outcry will be required to submit quotes and/or orders electronically to participate in the electronic Complex Order system.⁵

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 58099 (July 3, 2008), 73 FR 39769 (“Notice”).

⁴ The “Complex Orders” that may be traded on Phlx XL are spread orders, as defined in Phlx Rule 1066(f)(1); straddle orders, as defined in Phlx Rule 1066(f)(2); combination orders, as defined in Phlx Rule 1066(f)(3); ratio orders; and collar (risk reversal) orders. See Phlx Rule 1080, Commentary .08(a)(i).

⁵ See Phlx Rule 1080, Commentary .08(e)(ix).

As described briefly below and in greater detail in the Notice,⁶ the proposal establishes a Complex Order Opening Process (“COOP”), a Complex Order Book (“CBOOK”), and a Complex Order Live Auction (“COLA”). In addition, the proposal includes a Strategy Price Protection (“SPP”) feature that will prevent certain Complex Orders from trading at prices outside of specified pre-set limits.

COOP

After trading has opened in each component of a pending Complex Order or re-opened following a trading halt, the Phlx XL system will initiate the COOP.⁷ There will be one COOP per Complex Order Strategy.⁸ The COOP is composed of two components: (1) the COOP Timer, a period ranging from 0 to 600 seconds, as determined by the Phlx, during which the Complex Order will not trade; and (2) the COOP Evaluation, the period following the conclusion of the COOP Timer during which the Phlx XL system will determine which Complex Order on the CBOOK, if any, will be eligible for a COLA. Complex Orders received during the COOP Timer and the COOP Evaluation will reside on the CBOOK and will be visible to Phlx XL participants.⁹

At the conclusion of the COOP Timer, the Phlx XL system will identify the “COLA-eligible order,”¹⁰ if any, from market and marketable limit Complex Orders, including Complex

⁶ See Notice, supra note 3.

⁷ See Phlx Rule 1080, Commentary .08(d)(ii). However, as described in greater detail in the Notice, supra note 3, a COOP will not be initiated if any of the conditions in Phlx Rule 1080, Commentary .08(c)(ii) exist.

⁸ See Phlx Rule 1080, Commentary .08(d)(i). A “Complex Order Strategy” is any Complex Order involving any option series that is priced at a net debit or credit based on the relative prices of each component. See Phlx Rule 1080, Commentary .08(a)(ii).

⁹ See Phlx Rule 1080, Commentary .08(d)(ii)(A)(3) and (4).

¹⁰ A “COLA-eligible order” is a Complex Order (a) identified by way of a COOP; or (b) that, upon receipt, improves the cPBBO (i.e., the Phlx best net debt or credit price for a

Orders that cross the “cPBBO,”¹¹ and Complex Orders that improve the cPBBO, according to the methodology set forth in Phlx Rule 1080, Commentary .08(d)(ii)(B)(2). If the system receives no such orders, Complex Orders received during the COOP Timer will be placed on the CBOOK.¹²

COLA

COLA Broadcast and Responses

After identifying a COLA-eligible order, the Phlx will send a broadcast notice to Phlx XL participants¹³ indicating that the system has initiated a COLA. The broadcast message will identify the Complex Order Strategy, and the size of the order and any contingencies, but not the side of the market or the price.¹⁴ During the COLA Timer, which will not exceed five seconds, Phlx XL participants may bid and/or offer on either or both side(s) of the market by submitting one or more bids or offers that improve the cPBBO, known as “COLA Sweeps.”¹⁵ COLA Sweeps will not be visible to Phlx XL participants or disseminated by the Phlx.¹⁶ The

Complex Order based on the Phlx best bid or offer for the individual components of the Complex Order). See Phlx Rule 1080, Commentary .08(e)(i)(B)(1). The methodology for determining the COLA-eligible order is described in greater detail in the Notice, supra note 3.

¹¹ The cPBBO is the best net debit or credit price for a Complex Order based on the Phlx’s best bid and/or offer for the individual legs of the Complex Order. See Phlx Rule 1080, Commentary .08(a)(iv).

¹² See Phlx Rule 1080, Commentary .08(d)(ii)(B)(1).

¹³ Under the proposal, Phlx XL participants are Streaming Quote Traders (“SQTs”), Remote Streaming Quotes Traders (“RSQTs”), non-SQT Register Options Traders (“ROTs”), specialists and non-Phlx market makers on another exchange; non-broker-dealer customers and non-market maker off-floor broker-dealers; and Floor Brokers using the Options Floor Broker Management System. See Phlx Rule 1080, Commentary .08(a)(vii).

¹⁴ See Phlx Rule 1080, Commentary .08(e)(ii).

¹⁵ See Phlx Rule 1080, Commentary .08(e)(iii) and (iv).

¹⁶ See Phlx Rule 1080, Commentary .08(e)(iv)(C).

requirements in Phlx Rule 1080(c)(ii)(C) regarding trading as principal with agency orders will apply to Complex Orders and COLA Sweeps.¹⁷ Complex Orders for the same Complex Order Strategy as the COLA-eligible order may not be cancelled during the COLA.¹⁸

Executions and Allocations

If the system receives no COLA Sweeps or responsive Complex Orders during the COLA Timer, the COLA-eligible order may trade at the Phlx best bid or offer (“PBBO”) with quotes or orders on the limit order book for the components of the Complex Order, provided that the order can be executed in the correct ratio and at the desired price.¹⁹

If the system receives responses during the COLA Timer, the COLA-eligible order and the responsive COLA Sweeps or Complex Orders will trade, first, based on the best price or prices available at the end of the COLA Timer, with responses at the same price allocated in the following sequence: (1) customer marketable Complex Orders on the CBOOK; (2) COLA Sweeps on a size pro-rata basis; (3) SQT, RSQT, and non-SQT ROT Immediate or Cancel Complex Orders on a size pro-rata basis; and (4) non-market maker off-floor broker-dealers on a size pro-rata basis.²⁰

¹⁷ See Phlx Rule 1080, Commentary .08(e)(iv)(D). Phlx Rule 1080(c)(ii)(C) prohibits an Order Entry Firm from executing as principal against an order on the limit order book that it represents as agent unless: (a) the agency order is first exposed on the limit order book for at least three seconds; (b) the Order Entry Firm has been bidding or offering on the Phlx for at least three seconds prior to receiving the agency order that is executable against such order; or (c) the Order Entry Firm proceeds in accordance with the crossing rules in Phlx Rule 1064.

¹⁸ See Phlx Rule 1080, Commentary .08(e)(iii).

¹⁹ See Phlx Rule 1080, Commentary .08(e)(vi)(A)(1). An SQT or RSQT quoting all components of the Complex Order would have priority over SQTs and RSQTs quoting a single component, but would not have priority over customer orders. See Phlx Rule 1080, Commentary .08(e)(vi)(A)(1).

²⁰ See Phlx Rule 1080, Commentary .08(e)(v) and (vi)(B)(1) - (4). If the markets for the individual components of the COLA-eligible order improve during the COLA Timer and

Executions in the COLA will comply with the complex order priority requirements of Phlx Rule 1033(d).²¹ In addition, the COLA's priority rules provide that a non-broker-dealer customer's Complex Order will have priority over specialists, SQTs, RSQTs, and off-floor broker-dealers bidding for or offering any components of the Complex Order at the same price, but not over non-broker-dealer customer orders for any components of the Complex Order at the same price.²²

If the specialist submits a COLA Sweep at the same price as other COLA Sweeps, then, after any customer marketable Complex Orders have been executed against the COLA-eligible order, the specialist will be entitled to receive the greater of: (1) the proportion of the aggregate size at the cPBBO associated with the specialist's COLA Sweep, SQT and RSQT COLA Sweeps, and non-SQT ROT Complex Orders on the CBOOK; (2) the Enhanced Specialist Participation described in Phlx Rule 1014(g)(ii) - (iv); or (3) 40% of the remainder of the order.²³

match the best price of COLA Sweep(s) and/or responsive Complex Order(s), the system will execute the COLA Sweep(s) and/or responsive Complex Order(s) before executing the individual components of the COLA-eligible order. See Phlx Rule 1080, Commentary .08(e)(vi)(A)(2).

²¹ See Phlx Rule 1080, Commentary .08(e)(v). Phlx Rule 1033(d) provides that when a member holding a hedge order (i.e., a spread, straddle, or combination order), and bidding or offering on the basis of a total credit or debit for the order has determined that the order may not be executed by a combination of transactions at or within the bids and offers established in the marketplace, then the order may be executed as a hedge order at the total credit or debit with one other member with priority over either the bid or the offer established in the marketplace that is not better than the bids or offers comprising the total credit or debit, provided that the member executes at least one option leg at a better price than the established bid or offer for that contract and no option leg is executed at a price outside of the established bid or offer for that option contract.

²² See Phlx Rule 1080, Commentary .08(e)(vi)(A)(3).

²³ See Phlx Rule 1080, Commentary .08(e)(vi)(C). The specialist is not entitled to receive an allocation that would exceed the size of the specialist's COLA Sweep. See Phlx Rule 1080, Commentary .08(e)(vi)(C)(4).

The components of a COLA-eligible order may be executed in one-cent increments, regardless of the minimum quoting increments otherwise applicable to the individual legs of the order.²⁴

Treatment of Incoming Orders Received During the COLA

Incoming Complex Orders on the same side of the market as the COLA-eligible order that are received during the COLA will join the COLA, although the original COLA-eligible order will have priority at all price points over any incoming Complex Order, regardless of the price of the incoming order.²⁵ If the incoming Complex Order is not executed in its entirety, any remaining contracts will be placed on the CBOOK, subject to other instructions.²⁶

Incoming customer and non-customer Complex Orders on the opposite side of the market from the COLA-eligible order that have prices equal to or better than the best-priced COLA Sweep may execute against the COLA-eligible order or be placed on the CBOOK, subject to other instructions, if unexecuted interest remains in the incoming order after the COLA-eligible order has been executed in its entirety.²⁷ Incoming Complex Orders on the opposite side of the market that have a price inferior to the COLA Sweep Price(s) will execute against the COLA-eligible order after interest at the better COLA Sweep Price(s) has been executed. Any unexecuted remaining contracts in the incoming Complex Order will be placed on the CBOOK, subject to other instructions.²⁸

CBOOK

²⁴ See Phlx Rule 1080, Commentary .08(e)(v).

²⁵ See Phlx Rule 1080, Commentary .08(e)(viii)(B).

²⁶ Id.

²⁷ See Phlx Rule 1080, Commentary .08(e)(viii)(C)(1) and (2).

²⁸ See Phlx Rule 1080, Commentary .08(e)(viii)(C)(3).

Non-broker-dealer customer and non-market maker broker-dealer Complex Orders may be entered on the CBOOK.²⁹ An order resting on the CBOOK may execute against quotes or orders on the limit order book for the individual components of the order or against incoming Complex Order(s) that do not trigger a COLA Timer, whichever arrives first.³⁰ An incoming Complex Order that does not trigger a COLA Timer may execute against interest on the limit order book for the individual components of the order or against Complex Orders resting on the CBOOK.³¹ Complex Orders on the CBOOK may be executed in one-cent increments, regardless of the minimum increments applicable to the individual components of the Complex Order.³² Executions against orders on the CBOOK will comply with the complex order priority requirements of Phlx Rule 1033(d).³³ In addition, the CBOOK rules provide that a non-broker-dealer customer Complex Order will have priority over specialists, SQTs, RSQTs, and off-floor broker-dealers bidding for or offering any component(s) of a Complex Order at the same price, but not over non-broker-dealer customer orders representing any component(s) of the Complex Order at the same price.³⁴

SPP

²⁹ See Phlx Rule 1080, Commentary .08(f).

³⁰ See Phlx Rule 1080, Commentary .08(f)(iii)(A).

³¹ See Phlx Rule 1080, Commentary .08(f)(iii)(B).

³² See Phlx Rule 1080, Commentary .08(f)(i).

³³ See Phlx Rule 1080, Commentary .08(f)(iii)(B)(2).

³⁴ See Phlx Rule 1080, Commentary .08(f)(iii)(B)(3).

The SPP is a system feature that will prevent “Vertical Spreads”³⁵ and “Time Spreads”³⁶ from trading at prices outside of pre-set standard limits. If an execution would violate these limits, the system will place the order on the CBOOK.³⁷

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.³⁸ In particular, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,³⁹ which requires, in part, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, 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.

The Commission believes that the proposal to supplement the trading of complex orders on the Phlx’s floor with a facility for the electronic handling of Complex Orders is consistent with the Act.

³⁵ A Vertical Spread is a Complex Order Strategy consisting of the purchase of one call (put) option and the sale of another call (put) option overlying the same security that have the same expiration but different strike prices. See Phlx Rule 1080, Commentary .08(g)(i).

³⁶ A Time Spread is a Complex Order Strategy consisting of the purchase of one call (put) option and the sale of another call (put) option overlying the same security that have different expirations but the same strike price. See Phlx Rule 1080, Commentary .08(g)(ii).

³⁷ See Phlx Rule 1080, Commentary .08(g)(iii).

³⁸ In approving the proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

³⁹ 15 U.S.C. 78f(b)(5).

In particular, the Commission finds that the COOP is consistent with the Act because it is designed to provide an orderly procedure for opening electronic trading in Complex Orders. The Commission also finds that the rules for the display of orders on the CBOOK, which will be visible to Phlx XL participants, also are consistent with the Act and are likely to increase transparency.

In addition, the Commission finds that the COLA is consistent with the Act because it is designed to provide a competitive auction process, lasting up to five seconds, that could provide price improvement for COLA-eligible orders. During the COLA Timer, Phlx XL participants will be able to bid and/or offer on either or both sides of the market by submitting COLA Sweeps that improve the cPBBO. At the conclusion of the COLA Timer, the COLA-eligible order may execute against COLA Sweeps, Complex Orders received during the COLA, or, if the Phlx receives no COLA Sweeps or responsive Complex Orders, against existing interest on the limit order book for the individual components of the Complex Order. A member could elect to forego the COLA by sending its order to the Phlx's floor for execution.

The Commission finds that the Phlx's rules for the allocation of trades with Complex Orders are consistent with the Act. Executions of Complex Orders through the COLA and the CBOOK will comply with the complex order priority requirements of Phlx Rule 1033(d).⁴⁰ The CBOOK and COLA rules also provide that non-broker-dealer customer Complex Orders will have priority over specialists, SQTs, RSQTs, and off-floor-broker-dealers bidding for and/or offering any component(s) of the Complex Order at the same price, but not over non-broker-dealer customer orders representing any component(s) of the Complex Order at the same price.⁴¹

⁴⁰ See Phlx Rule 1080, Commentary .08(e)(v) and (f)(iii)(B)(2). See note 21, *supra*.

⁴¹ See Phlx Rule 1080, Commentary .08 (e)(vi)(A)(3) and (f)(iii)(B)(3). In addition, the COLA allocation rules provide that if a COLA-eligible order executes against interest in

The Commission notes that other options markets have comparable priority provisions for complex orders.⁴²

The COLA rules provide for a specialist participation guarantee equal to the greater of: (a) the proportion of the aggregate size at the cPBBO associated with such specialist's COLA Sweep, SQT and RSQT COLA Sweeps, and non-SQT ROT Complex Orders on the CBOOK (i.e., size pro rata); (b) the Enhanced Specialist Participation as described in current Phlx Rule 1014(g)(ii) to (iv); or (c) 40% of the remainder of the order. In addition, public customer Complex Orders that are marketable against the COLA-eligible order will have priority over the specialist's participation guarantee and the specialist will not be entitled to receive an allocation that would exceed the size of the specialist's COLA Sweep.⁴³

The Commission finds that the specialist participation guarantee in the COLA is consistent with the Act. The Commission notes that it has closely scrutinized exchange rule proposals relating to specialist guarantees to determine whether the specialist's participation would rise to a level that could have a material adverse impact on quote competition within a particular exchange.⁴⁴ Because the current proposal would not increase the overall percentage of an order that is guaranteed beyond the existing thresholds, the Commission does not believe that the proposal will negatively impact quote competition on the Exchange for Complex Orders.

The Commission also notes that it previously approved the Enhanced Specialist Participation for

the market for the individual components of the order, SQTs and RSQTs quoting all components of the Complex Order will have priority over SQTs and RSQTs quoting a single component, but not over customer orders. See Phlx Rule 1080, Commentary .08(e)(vi)(A)(1).

⁴² See, e.g., CBOE Rules 6.45A(b)(ii) and 6.45B(b)(ii); and ISE Rule 722(b)(2).

⁴³ See Phlx Rule 1080, Commentary .08(e)(vi)(C).

⁴⁴ See, e.g., Securities Exchange Act Release No. 43100 (July 31, 2000), 65 FR 48788 (August 9, 2000).

the individual components of the Complex Order.⁴⁵ To receive an Enhanced Specialist Participation in the COLA, the specialist must satisfy the applicable requirements in current Phlx Rule 1014(g)(ii) to (iv).

The Commission also notes that Phlx Rule 1080(c)(ii)(C), relating to an Order Entry Firm's trading as principal with agency orders, will apply to Complex Orders and COLA Sweeps.⁴⁶

Finally, the Commission finds that the SPP is consistent with the Act. It is designed to protect market participants by preventing the automatic execution of certain Complex Order Strategies outside of a pre-set acceptable price range, which the Phlx will communicate to members by Exchange Circular.⁴⁷ The Phlx XL system will place orders that would execute outside of the acceptable price range on the CBOOK, rather than executing them automatically.⁴⁸

⁴⁵ See Securities Exchange Act Release No. 41588 (July 1, 1999), 64 FR 37185 (July 9, 1999) (order approving File No. SR-Phlx-98-56).

⁴⁶ See Phlx Rule 1080, Commentary .08(e)(iv)(D).

⁴⁷ See Phlx Rule 1080, Commentary .08(g)(i)(C).

⁴⁸ See Phlx Rule 1080, Commentary .08(g)(iii).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁴⁹ that the proposed rule change (SR-Phlx-2008-50) is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁵⁰

Florence E. Harmon
Acting Secretary

⁴⁹ 15 U.S.C. 78s(b)(2).

⁵⁰ 17 CFR 200.30-3(a)(12).