



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
MARKET REGULATION

November 9, 2006

John Dayton, Esq.
Director and Counsel
Philadelphia Stock Exchange, Inc.
1900 Market Street
Philadelphia, PA 19103

Dear Mr. Dayton:

Based on the facts and representations set forth in your letter dated November 9, 2006, we find that it is appropriate in the public interest and consistent with the protection of investors to grant, and hereby grant, to XLE Participants (as defined in your letter) that execute trades for their customers on XLE, a facility of the Philadelphia Stock Exchange, Inc. ("Phlx"), a limited exemption pursuant to Rule 10b-10(f) under the Securities Exchange Act of 1934 ("Exchange Act") from the requirement in Rule 10b-10(a)(2)(i)(A) to disclose to their customers the name of the person from whom a security was purchased, or to whom it was sold, or the fact that such information will be provided upon the customer's written request. This exemption is limited to trades that XLE Participants execute on XLE using the post-trade anonymity feature described in your letter.¹

In granting the exemption, we note in particular that all single-sided orders in XLE will automatically match against each other, in strict price/time priority.

You also request assurance that the staff of the Division of Market Regulation ("Staff") will not recommend enforcement action to the Commission under paragraph (a) of Rule 10b-10 under the Exchange Act if an XLE Participant confirms its capacity as "agent" when the XLE Participant submits a customer's order through XLE, in the XLE Participant's role as the customer's agent, and the order is executed on XLE in a trade with an anonymous contra-party that turns out to be the XLE Participant trading in a principal (including proprietary) capacity. Your request is limited to those situations in which: (1) the representative of the XLE Participant submitting customer orders to XLE does not have knowledge of principal (including proprietary) orders ("Principal Orders")

¹ This exemption applies only to single-sided orders submitted by XLE Participants to XLE. It does not apply to those orders submitted by XLE Participants as two-sided "cross" orders, in which an XLE Participant submits an order to buy and sell the same security, or to orders routed to an away trading center for execution.

submitted by the XLE Participant or its affiliates, and the representative of the XLE Participant or its affiliate submitting Principal Orders to XLE does not have knowledge of customer orders submitted by the XLE Participant (the "No Knowledge Requirement"); and (2) the XLE Participant does not determine or influence the selection of the contra-party(ies) against which customer orders will be executed (the "Parity Requirement").

Based on the facts and representations set forth in your letter, the Staff will not recommend enforcement action to the Commission under paragraph (a) of Rule 10b-10 if an XLE Participant indicates on confirmations to its customers that the XLE Participant acted as agent on a customer's behalf when a representative of the XLE Participant submits a customer order to XLE on an agency basis and that order is executed in XLE in a trade with an anonymous contra-party that turns out to be the XLE Participant or its affiliate trading in a principal (including proprietary) capacity, provided that the XLE Participant complies with all other requirements of Rule 10b-10 in confirming the customer's order, including paragraph (a)(2)(i) thereof, and provided that the handling and execution of the customer order complies with the No Knowledge and Parity Requirements, as described in your letter.²

In taking this position, we note in particular your representation that you expect same firm volume, *i.e.*, an execution in which a firm's agency order is matched against the same firm's principal (including proprietary) trading interest ("Same Firm Volume"), as a percentage of total volume (other than "cross" order volume) in a security through XLE ("Total Volume") will not be material for either high or low trading volume securities.³ We also note that XLE Participants continue to have a duty of best execution.⁴

The Office of Financial Responsibility has instructed us to inform you that the Staff will not recommend enforcement action to the Commission if, in lieu of making and preserving a separate record, the XLE Participant relies on Phlx's retention of the

² This Staff position applies only to single-sided orders submitted by XLE Participants to XLE. It does not apply to those orders submitted by XLE Participants as two-sided "cross" orders, in which an XLE Participant submits an order to buy and sell the same security, or to orders routed to an away trading center for execution.

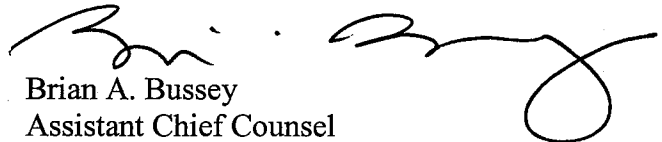
³ In this regard, we note your representation that one year following the launch of XLE you will review trade data to determine the actual percentage of Same Firm Volume versus Total Volume in high and low volume securities to confirm that this number is not material, and that you will create and maintain a record of your determination.

⁴ See, *e.g.*, Regulation NMS, Exchange Act Rel. No. 49325 (February 26, 2004), 69 Fed. Reg. 11126, 11137 (March 9, 2004) ("A broker-dealer still must seek the most advantageous terms reasonably available under the circumstances for all customer orders. A broker-dealer must carry out a regular and rigorous review of the quality of market centers to evaluate its best execution policies, including the determination as to which markets it routes customer order flow.").

identities of the XLE Participants that execute anonymous trades through XLE, for the period specified in Rule 17a-4(a), to satisfy the requirements of Rules 17a-3(a)(1) and 17a-4(a) under the Exchange Act. The Staff notes, however, that an XLE Participant has the responsibility to make, keep current, and preserve records of all purchases and sales of securities in accordance with Exchange Act Rules 17a-3 and 17a-4 for trades through Phlx if the XLE Participant knows the identity of the contra-party.

These exemptive and no-action positions are subject to modification or revocation if at any time the Commission or Staff determines that such action is necessary or appropriate in furtherance of the purposes of the Exchange Act. In addition, these positions are based solely upon the representations you have made and are limited strictly to the facts and conditions described in your incoming letter. Any different facts or circumstances, including any change to the operation of XLE, may require a different response.⁵ Finally, we express no view with respect to other questions the proposed activities of Phlx or any XLE Participant relying on this relief may raise, including the applicability of any other federal or state laws or the applicability of self-regulatory organization rules concerning customer account statements or confirmations.

For the Commission,
by the Division of Market Regulation,
pursuant to delegated authority,⁶


Brian A. Bussey
Assistant Chief Counsel

⁵ For example, the continued availability of these positions is dependent on Same Firm Volume as a percentage of Total Volume in fact not being material for either high or low trading volume securities one year following the launch of XLE and thereafter.

⁶ 17 C.F.R § 200.30-3(a)(32).

November 9, 2006

Ms. Catherine McGuire
Associate Director and Chief Counsel
Division of Market Regulation
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-6628

Re: Request for a Limited Exemption from Paragraph (a)(2)(i)(A) of Rule 10b-10 Under the Securities Exchange Act of 1934 (the "Act") and Request for No-Action Relief from Rules 10b-10(a)(2), 17a-3(a)(1) and 17a-4(a) Under the Act

Dear Ms. McGuire:

The Philadelphia Stock Exchange, Inc. ("Phlx" or the "Exchange") respectfully requests a limited exemption from paragraph (a)(2)(i)(A) of Rule 10b-10¹ under the Securities Exchange Act of 1934 ("Act") on behalf of XLE Participants² that execute trades on XLE for their customers. The Exchange submits this letter in conjunction with a recently approved rule change filed by the Exchange under Section 19 of the Act, and Rule 19b-4 thereunder, in connection with a new electronic trading system known as XLE that the Exchange is developing to replace the Exchange's current method for trading equity securities.³ Phlx's new system (and the new trading rules that are associated with XLE) will provide for a strict price-time priority execution for single sided orders.⁴ The system and rules will also provide for post trade anonymity through settlement for certain trades executed through XLE.⁵

¹ Paragraph (f) of Rule 10b-10 under the Act provides the Securities and Exchange Commission ("SEC" or "Commission") authority to issue exemptions from the requirements contained in paragraphs (a) and (b) of the rules promulgated under the Act.

² The term XLE Participants, as defined in Phlx Rule 1(nn), means "a member or member organization registered on XLE, a Sponsored Participant or a PAU." Phlx Rule 1(jj) defines a Sponsored Participant as "a person who has access to XLE which is authorized by a Sponsoring Member Organization." Phlx Rule 1(x) defines a PAU as "an individual authorized by a member organization or a Sponsored Participant to enter orders, on its behalf, on XLE."

³ The Exchange has tailored this exemption request to correspond to its rule filing, SR-Phlx-2006-43. *See* Securities Exchange Act Release No. 54538 (September 28, 2006), 71 FR 59184 (October 6, 2006) (Order approving SR-Phlx-2006-43, which proposed XLE). (The rules changes adopted herein were effective on September 28, 2006 but will not be operative until Phlx discontinues its physical equities trading floor and commences operation of XLE).

⁴ *See* Phlx Rules 184 and 185.

Phlx also requests, on behalf of XLE Participants, your assurance that the staff of the Division of Market Regulation (“Staff”) will not recommend that the Commission take any enforcement action under paragraph (a) of Rule 10b-10 under the Act in connection with the activities of XLE Participants executing orders for their customers in the circumstances described below. Specifically, Phlx requests this relief to permit a XLE Participant to indicate on a customer confirmation that the XLE Participant acted as agent (where the XLE Participant submits a customer’s order on XLE in the XLE Participant’s role as the Customer’s agent (hereinafter “Customer Order”)) and the order is executed in a trade with an anonymous contra-party that turns out to be the XLE Participant or one of its affiliates trading in a principal (including proprietary) capacity (hereinafter “Principal Order”), so long as the conditions set out below are met and the XLE Participant otherwise complies with all other requirements of Rule 10b-10 in confirming the customer’s order, including paragraph (a)(2)(i) thereof.

This request for no-action relief is limited, however, to those situations in which the following requirements are met: (1) the representatives of the XLE Participant or its affiliates submitting Principal Orders do not have knowledge about Customer Orders submitted by the XLE Participant and the XLE Participant representatives submitting Customer Orders do not have knowledge about Principal Orders submitted by the XLE Participant or its affiliates (the “No Knowledge Requirement”); and (2) the XLE Participant does not determine or influence the selection of the contra-party(ies) against which such Customer Orders will be executed (the “Parity Requirement”).

Finally, Phlx requests certain no-action relief from the requirements of Rules 17a-3(a)(1) and 17a-4(a) under the Act, as described below.

A. Background – Phlx and its New Trading System

Phlx’s new system (and trading rules) will provide for strict price-time priority execution for single sided orders. Phlx will maintain an electronic file of orders on XLE. Under Phlx Rules 184 and 185, single sided orders will be prioritized on a strict price-time basis, first by price and then by time. Incoming single sided orders are first matched for execution against orders on XLE. In addition, at the XLE Participant’s option, XLE may route orders that are not matched on XLE to a different market center for execution.⁶

⁵ As explained herein, the Exchange does not request an exemption for when it reveals the identify of a contra-party to a XLE Participant: (i) when required for legal or regulatory purposes; or (ii) if NSCC or SCCP ceases to act for a member organization or the member organization’s clearing firm, and NSCC or SCCP determines not to guarantee the settlement of the member organization’s trades.

⁶ Phlx understands that the exemptive and no-action relief would not apply to any situation in which Phlx routes an order to an away trading center for execution, as such executions would be governed by the rules of the away trading center.

All trades will be executed on XLE on an anonymous basis.⁷ Under the new rules, the Exchange would not reveal the contra-party's identity on a trade-by-trade basis to XLE Participants for their respective trades through any means, including any clearing or settlement reports.⁸ Consequently, under the new rules, the Exchange would maintain anonymity in execution through the end-of-day settlement process.

Moreover, XLE's trading algorithm permits orders originated by a XLE Participant to execute against other orders from the same XLE Participant on the same basis as orders from other XLE Participants. Under the system based on strict price-time priority, a XLE Participant could receive an execution against itself, and under the new rules, the XLE Participant would not be informed at the time of the execution that it was the contra-side of the trade.

B. New Rule to Adopt Total Anonymity through Settlement

Together with this request for a limited exemption from paragraph (a)(2)(i)(A) of Rule 10b-10, Phlx Rule 189 extends post trade anonymity so that, except for specific instances described below, the Exchange would not reveal the contra-party to the trade through settlement. XLE Participants often seek to trade anonymously to prevent market impact and the consequences that arise when the market has knowledge that a large order must be executed. In these instances, for example, the seller does not want the buyer to know its identity because it may reveal the existence of a large order to be filled. The Exchange believes that post-trade anonymity benefits investors because preserving anonymity through settlement limits the potential market impact that disclosing the XLE Participant's identity may have. Specifically, when the contra-party's identity is revealed, XLE Participants can detect trading patterns and make assumptions about the potential direction of the market based on the user's presumed client-base. For example, if the XLE Participant handles large institutional orders and becomes an active buyer in the security, others could anticipate such demand and adjust their trading strategy accordingly. This could result in increased transaction costs for the XLE Participant representing institutional orders.

⁷ Under the new system and rules, XLE Participants will not be able to direct orders to other XLE Participants. If, in the future, XLE Participants are permitted to direct orders to other XLE Participants through XLE, Phlx understands that any exemptive relief provided by the Commission in response to this request would not apply to such activities. It should be noted that Phlx, like other exchanges, does have rules that allow its members to submit crosses under certain prescribed circumstances. See Phlx Rule 185(c). As more fully described below, Phlx understands that the exemptive and no-action relief sought hereunder would not apply to crosses submitted under Phlx Rules 185(c) because the submitter of the cross would have knowledge of both sides of the trade.

⁸ Currently, for each trade executed in the system, Phlx produces an execution report that is sent to the parties of the trade. These reports contain a number identifying the member organization on the contra-side of any executions through Phlx trading system. Under the new system and trading rules, when an order is executed, the XLE Participants on the contra-side of the trade will not be identified.

The Exchange therefore believes that due to interest expressed by XLE Participants and the granting of exemptive relief to other markets to implement post-trade anonymity,⁹ it is essential for Phlx to offer XLE Participants anonymity through the settlement process. To facilitate Phlx's proposal, Phlx is working with the National Securities Clearing Corporation ("NSCC") and the Stock Clearing Corporation of Philadelphia ("SCCP") to accommodate anonymity on a post-trade basis. NSCC and SCCP will assign post-trade anonymous trades with a unique clearing number. Phlx will submit clearing records to NSCC and SCCP, which, pursuant to their rules, will report trades executed on XLE back to their clearing firms utilizing this unique clearing number.

Under specified circumstances, it might be necessary for Phlx to provide the identity of a contra-party to a XLE Participant on a trade by trade basis. As proposed, Phlx will reveal the contra-party only in those instances: (i) when required for legal or regulatory purposes; or (ii) if NSCC or SCCP ceases to act for a member organization or the member organization's clearing firm, and NSCC or SCCP determines not to guarantee the settlement of the member organization's trades.

C. Rule 10b-10

1. Contra-Party Identity Requirement

Rule 10b-10, among other things, requires a broker-dealer to disclose to its customers the identity of the party the broker-dealer sold to or bought from to fill the customer's order. Specifically, under paragraph (i)(A) or Rule 10b-10(a)(2), when a broker-dealer is acting as agent for a customer, some other person, or for both the customer and some other person, the broker-dealer must disclose "the name of the person from whom the security was purchased, or to whom it was sold, for such customer or the fact that the information will be furnished upon written request of such customer" (the "Contra-Party Identity Requirement"). A broker-dealer can provide this information on the confirmation, or it has the option to provide the information to a customer at a later time after receiving a written request from the customer. A broker-dealer has this option as long as it discloses on the confirmation that the contra-party information is available upon written request.

With the introduction of total anonymity at Phlx, the Exchange will not generally reveal the identity of the actual contra-party when the order is executed.¹⁰ Therefore, XLE Participants will not know the identity of the party to whom they sold securities or

⁹ See Letters from Brian A. Bussey, Assistant Chief Counsel, Division of Market Regulation, to Ms. Mai S. Shiver, Acting Director, Senior Counsel, Pacific Exchange, Inc. (April 30, 2004) and from Brian A. Bussey, Assistant Chief Counsel, Division of Market Regulation to Mr. James C. Yong, Chief Regulatory Officer, National Stock Exchange (October 13, 2006).

¹⁰ See previous section for a discussion of the circumstances in which the XLE Participant's identity will be revealed.

from whom they purchased securities.¹¹ Without this information, XLE Participants cannot comply with the Contra-Party Identity Requirement. To permit XLE Participants to utilize XLE without violating Rule 10b-10, the Exchange is seeking an exemption, on behalf of such XLE Participants, from the Contra-Party Identity Requirement when XLE Participants execute transactions using XLE.¹²

The Contra-Party Identity Requirement, in conjunction with the other requirements of paragraph (a)(2) of Rule 10b-10, is designed to provide customers with information that could alert them to potential conflicts of interest their broker-dealer may have had when handling their orders.¹³ The Exchange believes an exemption from the Contra-Party Identity Requirement when a XLE Participant trades through XLE¹⁴ would not diminish the public policy and investor protection objectives of the Contra-Party Identity Requirement of Rule 10b-10. The Exchange believes the potential for a conflict of interest is less likely in those circumstances when a XLE Participant trades through XLE because the trades are executed at the best price available on the Exchange and the contra-party is determined randomly based upon multiple factors not controlled by the XLE Participant. In such situations, XLE Participants on Phlx are not permitted the discretion in executing the order that would normally give rise to the opportunity for a conflict of interest.

2. Identification as Agent on Confirmation.

The Exchange requests no-action relief, on behalf of its XLE Participants, to permit XLE Participants to indicate on a customer confirmation that the XLE Participant has acted as agent where the XLE Participant submits a customer's order through XLE, in the XLE Participant's role as the customer's agent, and the order is executed in a trade with an anonymous contra-party that turns out to be the XLE Participant or one of its affiliates trading in a principal (including proprietary) capacity.

¹¹ Phlx understands that the exemptive and no-action relief sought hereunder applies only to single sided orders submitted to XLE. Phlx is not requesting exemptive or no-action relief for crosses submitted under Rules 185(c) because the submitter of the cross would have knowledge of both sides of the trade.

¹² See footnote 11.

¹³ Paragraph (a)(2) of Rule 10b-10 requires a broker-dealer to disclose on a confirmation to a customer the capacity in which the broker-dealer handled the customer's order (i.e. as agent or principal), and whether the broker dealer acted as agent for some other person, or as agent for both the customer and some other person. Paragraph (i)(D) of Rule 10b-10(a)(2) requires a broker-dealer to disclose to its customer the source and amount of remuneration received, or to be received, by the broker-dealer in connection with the trade.

¹⁴ See footnote 11.

No Knowledge Requirement

This request is limited to those circumstances in which the representatives of the XLE Participant and its affiliates submitting Principal Orders do not have knowledge about Customer Orders submitted by the XLE Participant, and the XLE Participant representatives submitting Customer Orders have no knowledge about Principal Orders submitted by the XLE Participant or its affiliates.¹⁵ A XLE Participant will be able to satisfy the No Knowledge Requirement if it implements and utilizes an effective system of internal controls such as appropriate information barriers, that operate to prevent the representatives of the XLE Participant or its affiliates submitting Principal Orders from obtaining knowledge about the Customer Orders submitted by the XLE Participant, and the representative of the XLE Participant submitting Customer Orders from obtaining knowledge about the Principal Orders submitted by the XLE Participant or its affiliates. To be effective, such a system of internal controls must include specific policies and procedures that prevent each Principal Order submitter separated by the information barriers from obtaining knowledge regarding Customer Orders submitted by the XLE Participant, and each Customer Order submitter separated by the information barriers from obtaining knowledge regarding Principal Orders submitted by the XLE Participant or its affiliates.

Parity Requirement

In addition to this No Knowledge Requirement, this request is limited to those situations in which the XLE Participant does not in any way determine or influence the selection of the trading interest against which a customer order will be executed.¹⁶ Other than for cross orders, the Phlx system will not support functionality that would allow a broker-dealer to select or influence against whom its orders will be executed.¹⁷

Where the Customer Order and the Principal Order are executed against each other by the system, a XLE Participant indicating in the confirmation that the firm has acted as agent does not increase the risk of fraud against the customer, where the No Knowledge Requirement and the Parity Requirement are met. To the contrary, the matching of the agency and proprietary trading interests occurs at the best price available and the contra-side is determined randomly based upon priority factors established by the

¹⁵ See footnote 11.

¹⁶ The SEC has issued no-action relief for Rule 10b-10 under these circumstances. See Letter from Brian A. Bussey, Assistant Chief Counsel, Division of Market Regulation, to Edward S. Knight, Executive Vice President and General Counsel, Nasdaq (January 26, 2005); and Letter from Brian A. Bussey, Assistant Chief Counsel, Division of Market Regulation to Aleksandra Radakovic, Vice President, J.P. Morgan Securities Inc. (August 4, 2005).

¹⁷ If such functionality were to be offered in the future, Phlx understands that the relief requested by this letter would not apply to this functionality.

rules of the Exchange, which have been approved by the Commission.¹⁸ Moreover, the proposed action does not diminish investor protection because it does not relieve an XLE Participant's duty of best execution.¹⁹

D. Books and Record Retention

Rule 17a-3(a)(1) under the Act requires that broker-dealers make and keep current records of all purchases and sales of securities, including "the name or other designation of the person from whom purchased or received or to whom sold or delivered." Rule 17a-4(a) under the Act requires that the records be preserved for six (6) years, the first (2) years "in an easily accessible place."

The Exchange asks that the Commission staff not recommend enforcement action to the Commission if, in lieu of making and preserving a separate record, a broker-dealer relies on the Exchange's retention of the identities of XLE Participants that execute anonymous trades through XLE to satisfy requirements of Rules 17a-3(a)(1) and 17a-4(a) under the Act. A broker-dealer would retain the responsibility to make, keep current and preserve records of all purchase and sales of securities in accordance with Exchange Act Rules 17a-3 and 17a-4 for trades through XLE if the broker-dealer knows the identity of the contra-party, including those instances where Phlx discloses the contra-party to a trade.

In view of the foregoing, the Exchange respectfully requests that the Commission issue an exemption and such other relief as reflected in this letter. If you have any questions, please contact

Sincerely,



John Dayton
Director and Counsel

¹⁸ Phlx expects that same firm volume, i.e. an execution in which a firm's agency order is matched against the same firm's principal (including proprietary) trading interest, as a percentage of total volume (other than cross order volume) in a security through XLE will not be material for either high or low trading volume securities. The Exchange represents that one year after XLE becomes fully operational, the Exchange will review trade data to determine the actual percentage of same firm volume versus total volume in high and low volume securities to confirm that this number is not material. The Exchange will create and maintain a record of the determination.

¹⁹ See Regulation NMS, Exchange Act Rel. No. 49325 (Feb. 26, 2004), 69 Fed Reg. 11126, 11137 (March 9, 2004) ("A broker-dealer still must seek the most advantageous terms reasonably available under the circumstances for all customer orders. A broker-dealer must carry out a regular and rigorous review of the quality of market centers to evaluate its best execution policies, including the determination as to which markets it routes customer order flow.")

Ms. Catherine McGuire

November 9, 2006

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cc: Brian Bussey, Division of Market Regulation, Securities and Exchange
Commission

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