

should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC, 20549. Also, copies of such filing will be available for inspection and copying at the principal office of the NYSE. All submissions should refer to File No. SR-NYSE-95-41 and should be submitted by February 14, 1996.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

Margaret H. McFarland,  
*Deputy Secretary*

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[Release No. 34-36728; File No. SR-Phlx-95-60]

**Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc; Order Granting Approval to Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2 to Proposed Rule Change Relating to Alternate Specialists**

January 17, 1996.

**I. Introduction**

On September 15, 1995, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "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 Rule 202A, which addresses the responsibilities of Alternate Specialists. On November 1, 1995, the Exchange submitted to the Commission Amendment No. 1 to the proposed rule change.<sup>3</sup>

The proposed rule change and Amendment No. 1 were published for comment in Securities Exchange Act Release No. 36457 (Nov. 3, 1995), 60 FR 57028 (Nov. 13, 1995). No comments were received on the proposal. On December 27, 1995, the Exchange submitted to the Commission Amendment No. 2 to the proposed rule change.<sup>4</sup>

This order approves the proposed rule change, including Amendment No. 2 on an accelerated basis.

**II. Description of Proposal**

An Alternate Specialist is a registered Phlx specialist, who with regard to certain assigned issues has agreed generally to supplement the market making activities of Exchange primary specialists. When called in to participate by the specialist or a Floor Official, Alternate Specialists assist the primary specialists in executing public orders during periods of unusual or heavy trading in a particular issue.<sup>5</sup> Phlx Rule 202A sets forth the requirements and responsibilities of Alternate Specialists. Currently, equity specialists are permitted to trade in an Alternate Specialist capacity all securities traded on the equity floor.

Phlx rule 202A imposes certain trading obligations upon Alternate Specialists pursuant to section 11 of the Act and the rule thereunder<sup>6</sup> as well as

30, 1995. In Amendment No. 1, the Exchange clarified that the "50% of quarterly opening share volume" requirement has been replaced with "50% of quarterly trade volume."

<sup>4</sup> See letter from Gerald O'Connell, First Vice President, Phlx, to Glen Barrentine, Team Leader, Division of Market Regulation, SEC, dated December 20, 1995. In Amendment No. 2, the Exchange clarified that the Alternate Specialist must clear the post before sending an order via ITS to obtain credit for the 50% on-floor requirement. Amendment No. 2 also withdrew the proposal to permit Alternate Specialists to count towards the 50% on-floor requirement unexecuted orders of 500 or more shares placed with the specialist on the Exchange at a price on or in-between the consolidated market and maintained on the book for an extended period of time.

<sup>5</sup> Phlx specialists and Alternate Specialists qualify for favorable margin treatment under Regulation T. Under Rule 12 of Regulation T, a creditor may extend good faith margin for any long or short position in a security in which a specialist makes a market. See 12 CFR 220.12(b)(3). Regulation T defines "good faith margin" as the amount of margin which a creditor, exercising sound credit judgment, would customarily require for a specified security position and which is established without regard to the customer's other assets or securities positions held in connection with unrelated transactions. See 12 CFR 220.2(k).

<sup>6</sup> 15 U.S.C. 78k. Generally, section 11(b) of the Act governs specialist rights and obligations. In particular, Rule 11b-1(a)(2) under the Act provides that the rules of an exchange concerning specialist registration must include provisions on the following: (1) Minimum capital requirements; (2) requirements that the specialist engage in a course of dealing for his own account that will assist in

financial responsibility and reporting requirements. An Alternate Specialist is obligated under Rule 202A to effect all of his transactions in securities on the Exchange so that they constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market. Moreover, an Alternate Specialist at the request of a floor broker must make a bid or offer in any security to which he is assigned or in which he is then trading such that a transaction effected thereon will contribute to the maintenance of a fair and orderly market.

The current rule also provides the criteria for qualifying and maintaining the status of an Alternate Specialist. Under the rule, 50% of an alternate Specialist's quarterly share volume (excluding share volume in securities in which he is registered as specialist) must be in issues to which he is assigned. Moreover, 50% of the quarterly share volume that creates or increases a position ("opening") in an Alternate Specialist account must result from transactions consummated on the Exchange.

Finally, the current rule contains several provisions that focus on the Alternate Specialist's participation on openings and after the opening and the handling of orders. Supplementary Material .06 to Phlx Rule 202A provides that alternate Specialists as a group are entitled to participate in opening a security on the Exchange with equal standing with respect to any net imbalance (after specialist participation) of purchase and sale orders on the exchange. Moreover, pursuant to Supplementary Material .07 to Phlx Rule 202A, following the opening, when the bids or offers of one or more Alternate Specialists are equal in price to those of the specialist, the Alternate Specialists as a group are entitled to participate in the transactions effected thereon to the extent of one-third of the total shares involved (excluding those needed to satisfy public orders). Pursuant to Supplementary Material .09 to Rule 202A, an Alternate Specialist must also accept and guarantee execution of all 100 share agency orders to which his assignment extends that

the maintenance of a fair and orderly market and that substantial, continued failure to meet these requirements will result in suspension or cancellation of the specialist's registration in his specialty stock(s); (3) provisions restricting the specialist's dealings to those necessary to maintain a fair and orderly market or to act as an odd-lot dealer; (4) provisions stating the responsibilities of the specialist as broker; and (5) procedures for the effective and systematic surveillance of specialist activities. Phlx Alternate Specialists are considered specialists as envisioned by Section 11 of the Act.

<sup>10</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> See letter from Gerald D. O'Connell, First Vice President, Phlx, to Glen Barrentine, Team Leader, Division of Market Regulation, SEC, dated October

are not accepted by the specialist when requested by a floor broker.

The Exchange proposes to amend certain obligations and responsibilities of Alternate Specialists set forth in Phlx Rule 202A. Specifically, the Exchange proposes to consolidate into new Rule 202A(a) the provisions relating to an Alternate Specialist's affirmative and negative market making obligations. The Exchange believes that this change will avoid repetition and improve the clarity of the rule.

In new Rule 202A(b), Phlx proposes to limit the number of equity issues in which an individual may serve as Alternate Specialist to 60 securities. Moreover, the Exchange proposes that once a member has been assigned as an Alternate Specialist, the member must maintain such assignment for at least 30 business days, after which the member may terminate the assignment by providing written notification to the Phlx on a form prescribed by the Exchange.<sup>7</sup> The Exchange states that the primary purpose of the proposed rule change is to bolster liquidity provided by the Phlx's Alternate Specialist program by concentrating Alternate Specialist activities in a smaller number of securities.

Finally, the Exchange proposes new Rule 202A(c), which will list the criteria for qualifying and maintaining the status of an Alternate Specialist. This provision incorporates and amends certain previous requirements and eliminates others that the Exchange finds to be unnecessary in light of other Exchange rules. In particular, the Exchange proposes to delete the requirement that 50% of the Alternate Specialist's share volume must be in assigned issues. The Exchange believes that this requirement is no longer necessary in light of its proposal to limit the maximum number of securities in which a specialist can act as an Alternate Specialist to 60. Moreover, the Exchange proposes to amend the requirement that 50% of the quarterly opening share volume in an Alternate Specialist account result from transactions consummated on the Exchange ("50% on-floor requirement") by replacing the "50% of quarterly opening share volume" with "50% of quarterly trade volume." The Exchange states that it has determined that the requirement should no longer be limited to "opening" positions because measuring all trade volume each quarter to ensure that 50% is executed on the Exchange should fulfill the Phlx's intent

<sup>7</sup> Terminations will become effective as of the opening of trading on the equity floor on the business day following the submission.

to monitor for true Alternate Specialist activity and obligations. The Exchange also notes that opening transactions are difficult to monitor because floor tickets are not marked with an opening or closing distinction on the equity floor.

The Exchange also proposes to amend the 50% on-floor requirement to permit Alternate Specialist to include in the calculation trades effected on another national securities exchange through the Intermarket Trading System ("ITS") that do not exceed a ratio of three Phlx trades to one ITS trade.<sup>8</sup> For an ITS trade to count toward such a requirement, however, the Alternate Specialist must first "clear the post" before routing an ITS commitment to another market.<sup>9</sup> The Exchange believes that it is appropriate to allow one-quarter of the 50% on-floor requirement to be met by ITS trades effected away from the Exchange because ITS enhances liquidity and provides a linkage that is vital to a true National Market System.

The Phlx also proposes to delete Supplementary Material .06, .07, and .09. The Exchange proposes to delete Supplementary Material .06 and .07, which pertain to Alternate Specialist's participation, because it believes that the priority of orders is already adequately addressed in Rules 119 and 120.<sup>10</sup> The Phlx also proposes to delete Supplementary Material .09, which relates to Alternate Specialist's handling of orders, because it believes that the obligation on the Alternate Specialist to accept and guarantee executions only pertains to 100 share orders and will be largely superseded by new Rule 202A(c)(iv), where the Alternate Specialist's affirmative obligation to maintain an adequate presence in his assigned issues is more pronounced.

<sup>8</sup> For example, if an Alternate Specialist needs to employ ITS trades to meet his on-floor requirement, and has executed a total of 2,000 trades in that quarter, the requirement could be met by effecting 250 off-floor ITS trades and 750 on-floor trades.

<sup>9</sup> Specifically, before sending an order initiated on the Exchange floor to another market, the Alternate Specialist must (1) request the specialist's quote and (2) make a bid or offer at the post for the price and size of his intended interest. See Securities Exchange Act Release No. 20331 (Oct. 27, 1983), 48 FR 50649 (Nov. 2, 1983) (approving a proposed rule change to require all Phlx floor members to clear the post for a security on the Phlx floor before directly inputting the order into the Intermarket Trading System; alternate specialists are also required to bid or offer at the post for the price and size of their intended interest prior to transmitting a commitment to another market via the ITS).

<sup>10</sup> See Phlx Rule 119 (Precedence of Highest Bid) and Phlx Rule 120 (Precedence of Offers at Same Price).

### III. Discussion

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, and, in particular, with the requirements of sections 6(b) and 11(b).<sup>11</sup> In particular, the Commission believes the proposal is consistent with the section 6(b)(5) requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, and, in general, to protect investors and the public interest. The Commission also believes that the proposed rule change is consistent with the requirement of section 11(b) and Rule 11b-1 thereunder<sup>12</sup> that specialist transactions must contribute to the maintenance of fair and orderly markets.

The Commission believes that limiting the number of issues in which an equity specialist may serve as an Alternate Specialist to 60 would assist in adding depth and liquidity to the market. By placing a limit on the number of Alternate Specialist issues, the Alternate Specialist can more effectively utilize his capital and focus his liquidity providing activities on 60 issues rather than on potentially over 2,300 issues.

The Commission also believes that the consolidation into new Rule 202A(a) of the Alternate Specialist's affirmative and negative market making obligations is consistent with the purposes of the Act in that the requirements of section 11(b) of the Act and Rule 11b-1(a)(2) thereunder remain intact: Alternate Specialists must continue to adhere to minimum capital requirements as well as the requirement that the Alternate Specialist trading contribute to the maintenance of a fair and orderly market. Moreover, the proposed rule change does not affect the Alternate Specialist's obligations as an equity specialist when he is not otherwise acting in his capacity as an Alternate Specialist. Finally, Phlx's specialist compliance and surveillance rules continue to apply to the Exchange's Alternate Specialist program. Therefore, the Commission believes that these rules will ensure that Alternate Specialist trading will be beneficial to investors and the market in general.

The Commission also believes that the amendments to the two quarterly trading requirements are not inconsistent with the Act. The requirement that 50% of the Alternate

<sup>11</sup> 15 u.S.C. 78f(b) and 78k(b).

<sup>12</sup> 17 CFR 240.11b-1.

Specialist's share volume be in assigned issues may be deleted because with only 60 securities in which a specialist may serve as an Alternate Specialist and the adoption of the new standards in the rule, it is permissible for Phlx to decide that an aggregate minimum level of Alternate Specialist activity is no longer necessary to ensure that Alternate Specialists are acting as section 11(b) specialists. Moreover, the 50% requirement spread over potentially 2,300 securities did not guarantee significant depth or liquidity in individual stocks. The Commission believes that new Rule 202A(c)(iv), which places affirmative obligations on the Alternate Specialist to maintain an adequate presence in the Exchange's market with respect to assigned issues and to execute at least 50% of the trades placed in the Alternate Specialist account each quarter on the Exchange, in addition to the limitation in the number of securities for which a specialist may act as an Alternate Specialist should ensure sufficient Alternate Specialist participation on the Exchange and liquidity in individual stocks.

With respect to the 50% on-floor requirement, the Exchange proposes to calculate the percentage of quarterly trade volume rather than "opening" share volume. The Commission believes that with this amendment the Exchange can monitor the frequency of Alternate Specialist participation on the Exchange, which would be as helpful as the prior requirement in measuring whether Alternate Specialists are fulfilling their obligations to provide liquidity on the Exchange. Moreover, eliminating the "opening" distinction will make it easier for the Exchange to monitor compliance with the requirement.

Moreover, the Commission believes that amending the 50% on-floor requirement to permit Alternate Specialist to include in the calculation ITS trades will not be inconsistent with the purposes of the Act. The Exchange specifically requires that the Alternate Specialist clear the post before routing an ITS commitment to another market. Where one of the primary obligations of Alternate Specialists is to provide liquidity on demand, permitting Alternate Specialists to count ITS trades towards their 50% on-floor requirement would encourage and recognize Alternate Specialists activities that contribute to the liquidity of the National Markets. Moreover, the Commission recognizes that an Alternate Specialist who initiates an order on the floor and clears the post should not be penalized if there is no

interest in the crowd or on the limit order book against which the Alternate Specialist's order can be executed and if the specialist does not accept that order for placement in the book. The Commission finds that it is reasonable for the Exchange to assume that an Alternate Specialist who makes a good faith effort to participate as dealer on the Exchange floor is engaged in bona fide specialist activity even though the transaction ultimately can be consummated only by exposing the Alternate Specialist's order to all interest in the National Market System. Moreover, the Commission finds that the limit on the amount of ITS trades that may be counted towards the 50% on-floor requirement should ensure that the Alternate Specialists are actually engaging in bona fide equity specialist activity on the Phlx floor entitled to exempt credit.

Finally, the Commission finds that the Exchange's rules of priority and precedence of orders adequately address the concerns in Supplementary Material .06 and .07. Moreover, the Commission believes that the Exchange's proposal to delete Supplementary Material .09 is not inconsistent with the purposes of the Act. Although the affirmative obligations upon Alternate Specialist in the proposed rule change do not require the Alternate Specialist to guarantee execution of any specific number of shares, Phlx rules require Alternate Specialists to maintain an adequate presence on the Exchange with respect to assigned alternate issues and related trade activities for the alternate account. This standard will ensure that, when needed, the Alternate Specialist will be available to assist in executions as required of all specialists under section 11(b) of the Act.<sup>13</sup>

Moreover, the Commission finds good cause for approving Amendment No. 2 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof. Amendment No. 2 merely clarified a requirement on the Alternate Specialist to clear the post before routing an order to another market through ITS<sup>14</sup> and withdrew from consideration of the proposed rule change an amendment to permit Alternate Specialists to count towards the 50% on-floor requirement unexecuted orders of 500 or more shares placed with the Specialist on the Exchange. Both these changes to the proposal strengthen the Phlx's Alternate

<sup>13</sup> Indeed, the Commission would question whether regular or alternate specialists were fulfilling their Section 11(b) obligations if they refused to accept for execution certain orders (e.g., 100 share agency orders).

<sup>14</sup> See *supra* note 9.

Specialist rules. In addition, the Exchange's original proposal was published in the Federal Register for the full statutory period and no comments were received.<sup>15</sup> Based on the above, the Commission finds that there is good cause, consistent with Section 6(b)(5) of the Act, to accelerate approval of Amendment No. 2.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 2. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549. Copies of the submission, all subsequent amendments, all written statement with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-Phlx-95-60 and should be submitted by February 14, 1996.

#### V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,<sup>16</sup> that the proposed rule change (SR-Phlx-95-60), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

Margaret H. McFarland,

*Deputy Secretary.*

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<sup>15</sup> See Securities Exchange Act Release No. 36457 (Nov. 3, 1995), 60 FR 57028 (Nov. 13, 1995).

<sup>16</sup> 15 U.S.C. 78s(b)(2).

<sup>17</sup> 17 CFR 200.30-3(a)(12).