

The proposed rule change also will adopt Commentary .08 to Rule 731 that extends the applicability of the rule to portfolio depositary receipts, index fund shares, and TIRs orders to buy or sell a security where the price is derivatively based upon another security or index of securities.<sup>8</sup> The proposed Commentary also provides that Amex may establish separate times to review and resolve DKs in these products.

### III. Discussion

Section 6(b)(5) of the Act requires that the rules of an exchange are designed, among other things, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities.<sup>9</sup> The proposed rule change permits Amex flexibility in establishing time periods for resolution of DKs and extends the application of the rule to additional types of securities that previously had not been covered by the rule. This flexibility should enable Amex to address issues in its comparison process that may arise from market conditions or from various products trading on Amex. In so doing, Amex should be able to improve its ability to resolve uncompleted trades, which in turn will improve the clearance and settlement of securities trading on Amex. For the reasons set forth above, the Commission believes that the AMEX's rule change is consistent with the exchange's obligations under the Act.

### IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular with the requirements of section 6(b)(5) of the Act and the rules and regulations thereunder.

*It Is Therefore Ordered*, pursuant to section 19(b)(2) of the Act, that the proposed rule change (File No. SR-AMEX-2002-36) be and hereby is approved.

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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<sup>8</sup> Orders to buy or sell an option will continue to be covered by Rule 950(f) and the applicable Commentary to Rule 950.

<sup>9</sup> 15 U.S.C. 78(f).

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

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47420; File No. SR-NQLX-2003-04]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by Nasdaq Liffe Markets, LLC, Relating to Revised Reporting Requirements for Exchange for Physical Trades

February 27, 2003.

Pursuant to section 19(b)(7) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-7 under the Act,<sup>2</sup> notice is hereby given that on February 11, 2003 Nasdaq Liffe Markets, LLC ("NQLX") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change described in Items I, II, and III below, which Items have been prepared by NQLX. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. NQLX also filed the proposed rule change with the Commodity Futures Trading Commission ("CFTC"), together with written certifications on February 6, 2003 under Section 5c(c) of the Commodity Exchange Act<sup>3</sup> ("CEA").<sup>4</sup>

#### I. Self-Regulatory Organization's Description of the Proposed Rule Change

NQLX proposes to adopt a change to its Rule 420(b) relating to the reporting, submission, and dissemination of trade information concerning exchange for physical trades.<sup>5-7</sup> The proposed change

<sup>1</sup> 15 U.S.C. 78s(b)(7).

<sup>2</sup> 17 CFR 240.19b-7.

<sup>3</sup> 7 U.S.C. 7a-2(c).

<sup>4</sup> Telephone conversation between Kathleen Hamm, Senior Vice President of Regulation and Compliance, NQLX, and Ian K. Patel, Attorney, Division of Market Regulation ("Division"), Commission on February 24, 2003.

<sup>5-7</sup> An exchange for physical trade occurs between two parties where the first party sells, and the second party buys, the related physical (e.g., the common stock underlying a security futures contract) while simultaneously the first party buys, and the second party sells, an appropriate number of futures contracts, known as the "futures leg" of the transaction. See NQLX Rule 420(a)(2). Exchange for physical trades allow certainty of execution at one place and in one transaction for the two parties to the transaction instead of requiring the parties to execute multiple transactions across several exchanges, which inherently creates risk that one market will move before the entire transaction can be executed. Generally, on futures exchanges, exchange for physical trades are negotiated and effected by parties outside the centralized market, and the exchange reports the futures leg as either transferred, newly created, or offset. Johnson and Hazen, *Commodities Regulation* § 1.03[3] (3d ed. 2002). The CEA and the regulations of the CFTC both recognize exchange for physical trades as properly executed outside the centralized market.

would allow the reporting and dissemination of information related to exchange for physical trades effected by sophisticated and experienced customers (i.e., "wholesale customers") during hours other than trading hours for the futures leg of the transaction on the next trading day. As for exchange for physical trades effected for customers other than those meeting the definition of wholesale customers, there would be no change to the reporting requirements and those transactions would still need to be transacted during trading hours on the exchange and reported as soon as practicable but not longer than 30 minutes after the arranging of the transaction. Below is the text of the proposed rule change. Proposed new language is italicized. Proposed deletions are in [brackets].

#### Rule 420 Exchange for Physical Trades

\* \* \* \* \*

##### (b) Information Recording, Submission, and Dissemination

(1) No change.  
(2) As soon as practicable but no later than (i) 30 minutes after *effecting an Exchange for Physical Trade during trading hours on Market Days* or (ii) 15 minutes after the opening of trading for the Futures Leg on the first Market Day after effecting an Off-Hours Exchange for Physical Trade, the Member—when the transaction is between a Member and a Customer—and the Member selling the Futures Leg—when the transaction is between two Members unless otherwise mutually agreed to by the two Members—must submit through the ATS the following information concerning the Exchange for Physical Trade:

- (i) to (xii) No change.
- (xiii) quantity of the Related Physical, [and]
- (xiv) to (xv) No change.
- (3) No change.
- (4) After sending the confirmation for the Exchange for Physical [t]Trade, NQLX will disseminate through the ATS the following information:
  - (i) to (vi) No change.
  - (5) to (7) No change.

\* \* \* \* \*

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

NQLX has prepared statements concerning the purpose of, and basis for, the proposed rule change, burdens on

Commodity Exchange Act § 5(b)(3), 7 U.S.C. 7a-1 (2000) and CFTC Regulation § 1.38, 17 CFR 1.38; see *Id.*

competition, and comments received from members, participants, and others. The text of these statements may be examined at the places specified in Item IV below. These statements are set forth in Sections A, B, and C below.

*A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change*

1. Purpose

Simultaneously with this filing, NQLX submitted to and certified with the CFTC, proposed rule changes to NQLX Rules 101(a)(79) and 420(a). These proposed changes would allow members and persons associated with members to effect exchange for physical trades for sophisticated and experienced customers (known as "wholesale customers"<sup>8</sup>) during hours other than trading hours for the futures leg of the transaction.<sup>9</sup> NQLX states that its general rule provisions on exchange for physical trades (NQLX Rule 420(a)), as well as its proposed changes to those provisions and the related definition of wholesale customers (NQLX Rule 101(a)(79)), do not fall within the categories of changes required to be submitted to the Commission for publication.<sup>10</sup> However, to implement the proposed changes to Rules 101(a)(79) and 420(a), NQLX proposes adopting a change to its Rule 420(b) relating to the reporting, submission, and dissemination of trade information for exchange for physical trades.<sup>11-13</sup>

The proposed rule change to NQLX Rule 420(b) would require a member to report trade information on exchange for physical trades effected after the close of trading for wholesale customers within 15 minutes after the opening of trading on the next trading day. As for exchange for physical trades effected for customers other than those meeting the

definition of wholesale customers or effected for any customer during trading hours, there would be no change to the reporting requirements and those transactions would still need to be transacted during trading hours on the exchange and reported as soon as practicable but not longer than 30 minutes after the arranging of the transaction. The remaining proposed changes to Rule 420(b) correct typographical errors.

2. Statutory Basis

NQLX files this proposed rule change pursuant to Section 19(b)(7) of the Act.<sup>14</sup> NQLX believes that the proposed rule change is consistent with the requirements of the Commodity Futures Modernization Act of 2000,<sup>15</sup> including the requirement that trading in a listed security futures contract is not readily susceptible to manipulation of its price nor to causing or being used to manipulate the price of the underlying security, options on the security, or options on a group or index including the security.<sup>16</sup> NQLX further believes that its proposed rule change complies with the requirements under Section 6(h)(3) of the Act<sup>17</sup> and the criteria under Section 2(a)(1)(D)(i) of the CEA,<sup>18</sup> as modified by joint orders of the Commission and the CFTC. In addition, NQLX believes that its proposed rule change is consistent with the provisions of Section 6 of the Act,<sup>19</sup> in general, and Section 6(b)(5) of the Act,<sup>20</sup> in particular, which requires, among other things, that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to facilitate transactions in securities and, in general, to protect investors and the public interest.

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

NQLX does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

NQLX neither solicited nor received written comment on the proposed rule change.

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Concurrent with the filing of the proposed rule change with the SEC, NQLX has filed on February 6, 2003 a written certification with the CFTC under Section 5c(c)<sup>21</sup> of the CEA and CFTC Regulation Part 40.6<sup>22</sup> in which NQLX certifies that it believes that its proposed changes to Rule 420 as well as Rule 101(a)(79) comply with the CEA. Proposed changes to Rules 101(a)(79) and 420 are effective on February 7, 2003, the day after their filing with the CFTC.

Within 60 days of the date of effectiveness of the proposed rule change, the Commission, after consultation with the CFTC, may summarily abrogate the proposed rule change and require that the proposed rule change be refiled in accordance with the provisions of Section 19(b)(1) of the Act.<sup>23</sup>

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change conflicts with the Act. Persons making written submissions should file nine copies of the submission with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Comments also may be submitted electronically to the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). 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 in the Commission's Public Reference Room. Copies of these filings also will be available for inspection and copying at the principal office of NQLX. All submissions should refer to File No. SR-NQLX-2003-04 and should be submitted by March 28, 2003.

<sup>8</sup> NQLX Rule 101(a)(79), as amended would revise the definition of wholesale customer to require that a customer receive notification from a Member that the customer is not only qualified to participate in block trades, but is also qualified to participate in exchange for physical trades at times other than during trading hours on market days for the futures leg.

<sup>9</sup> The rules of other futures exchanges allow exchange for physical trades to be effected after the close of trading and reported shortly after opening of trading the following trading day. See e.g., New York Futures Exchange Rule 303(e)(5)(iii)(2); Coffee, Sugar & Cocoa Exchange Rule 3.06(e)(iii)(2).

<sup>10</sup> 15 U.S.C. 78s(7)(A).

<sup>11-13</sup> NQLX previously submitted its Rule 420(b) to the Commission for publication as part of its rules related to the establishment of audit trails necessary or appropriate to facilitate coordinated market surveillance. Securities Exchange Act Release No. 46774, (November 5, 2002) 67 FR 68895, 68897 (November 13, 2002); see also 15 U.S.C. 78f(h)(3)(J).

<sup>14</sup> 15 U.S.C. 78s(b)(7).

<sup>15</sup> Public Law 106-554, 114 Stat. 2763 (2000).

<sup>16</sup> See Section 6(h)(3)(H) of the Act, 5 U.S.C. 78f(h)(3)(H).

<sup>17</sup> 15 U.S.C. 78f(h)(3).

<sup>18</sup> 7 U.S.C. 2(a)(1)(D)(i).

<sup>19</sup> 15 U.S.C. 78f.

<sup>20</sup> 15 U.S.C. 78f(b)(5).

<sup>21</sup> 7 U.S.C. 7a-2(c).

<sup>22</sup> 17 CFR 38.4.

<sup>23</sup> 15 U.S.C. 78s(b)(1).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>24</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47417; File No. SR-Phlx-2002-61]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment No. 1 Thereto by the Philadelphia Stock Exchange, Inc. To Amend Options Floor Procedure Advice A-13 To Include Violations for Failure To Obtain Approval To Disengage the NBBO Feature in the Exchange's Minor Rule Plan

February 27, 2003.

On October 4, 2002, 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"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend Phlx Option Floor Procedure Advice ("OFPA") A-13, Auto Execution Engagement/Disengagement Responsibility, to include in the Exchange's minor rule violation enforcement and reporting plan ("Minor Rule Plan")<sup>3</sup> violations for failure to obtain the necessary approvals prior to disengagement of the National Best Bid/Best Offer ("NBBO") Feature of the Exchange's Automated Options Market System ("AUTOM").<sup>4</sup> The Exchange's NBBO Feature automatically executes orders at the NBBO for certain options designated by the Phlx's Options Committee as eligible for the NBBO Feature ("automatic step-up options"), provided that the NBBO does not differ

from the specialist's bid or offer by more than the "step up parameter."<sup>5</sup> Currently, engagement and disengagement of the NBBO Feature is governed solely by Phlx Rule 1080(c)(i), and violations are referred to the Business Conduct Committee ("BCC").

The Exchange proposed to amend OFPA A-13 to restate from Phlx Rule 1080(c)(i) the conditions for using the NBBO Feature, including the requirement to obtain approval to disengage the NBBO Feature, and to include a fine schedule for failure to obtain such approval. Specifically, the proposed fine schedule is as follows: First occurrence, \$250; second occurrence, \$500; third occurrence, \$1,000; fourth occurrence and thereafter, sanction discretionary with the BCC. The proposed fine schedule would be implemented on a one-year running basis. The BCC also would have discretion concerning sanctions for any violations should they be deemed egregious by the Exchange's Enforcement Department and referred directly to the BCC pursuant to Exchange Rule 960.2.

On November 7, 2002, the Exchange submitted Amendment No. 1 to the proposed rule change.<sup>6</sup> The proposed rule change, as amended, was published in the **Federal Register** on January 22, 2003.<sup>7</sup> The Commission did not receive any comment letters on the proposed rule change. This order approves the proposed rule change, as amended.

The Commission has carefully reviewed the proposal and finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange<sup>8</sup> and, in particular, the requirements of section 6 of the Act<sup>9</sup> and the rules and regulations thereunder. The Commission finds specifically that the proposed rule change is consistent with section 6(b)(6) of the Act<sup>10</sup> in that it provides a procedure whereby member

organizations can be disciplined appropriately in those instances when a rule violation is minor in nature, but a sanction more serious than an admonition letter is appropriate. Additionally, the Commission finds that the proposed rule change is consistent with the requirements of sections 6(b)(7)<sup>11</sup> and 6(d)(1)<sup>12</sup> of the Act. Section 6(b)(7) requires the rules of an exchange to be in accordance with the provisions of section 6(d) of the Act, and, in general, to provide a fair procedure for the disciplining of members and persons associated with members. Section 6(d)(1) requires an exchange to bring specific charges, notify such member or person of, and give him an opportunity to defend against, such charges, and keep a record, in any proceeding to determine whether a member or person associated with a member should be disciplined. Finally, the Commission finds the proposal is consistent with Rule 19d-1(c)(2) under the Act,<sup>13</sup> which governs minor rule violations plans.

In approving this proposal, the Commission in no way minimizes the importance of compliance with these rules, and all other rules subject to the imposition of fines under the Exchange's Minor Rule Plan. The Commission believes that the violation of any self-regulatory organization's rules, as well as Commission rules, is a serious matter. However, in an effort to provide the Exchange with greater flexibility in addressing certain violations, the Exchange's Minor Rule Plan provides a reasonable means to address rule violations that do not rise to the level of requiring formal disciplinary proceedings. The Commission expects that the Phlx will continue to conduct surveillance with due diligence, and make a determination based on its findings whether fines of more or less than the recommended amount are appropriate for violations of rules under the Exchange's Minor Rule Plan, on a case by case basis, or if a violation requires formal disciplinary action.

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>14</sup> that the proposed rule change (SR-Phlx-2002-61), as amended, is approved.

<sup>24</sup> 17 CFR 200.30-3(a)(75).

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

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

<sup>3</sup> The Exchange's Minor Rule Plan, codified in Exchange Rule 970, includes Floor Procedure Advices with accompanying fine schedules.

<sup>4</sup> AUTOM is the Exchange's electronic order delivery, routing, execution and reporting system, which provides for the automatic entry and routing of equity option and index option orders to the Exchange trading floor. Orders delivered through AUTOM may be executed manually, or certain orders are eligible for AUTOM's automatic execution feature, AUTO-X. Equity option and index option specialists are required by the Exchange to participate in AUTOM and its features and enhancements. Option orders entered by Exchange members into AUTOM are routed to the appropriate specialist unit on the Exchange trading floor.

<sup>5</sup> For a complete description of the NBBO Feature, see Securities Exchange Act Release No. 43684 (December 6, 2000), 65 FR 78237 (December 14, 2000) (order partially approving SR-Phlx-00-93).

<sup>6</sup> See letter from Rick Rudolph, Director and Counsel, Phlx, to Jennifer Lewis, Commission, dated November 6, 2002 ("Amendment No. 1"). In Amendment No. 1, Phlx fixed nonsubstantive typographical errors in its rule text, and added a cross-reference to Phlx Rule 960.2 in the purpose section of its proposal.

<sup>7</sup> See Securities Exchange Act Release No. 47166 (January 10, 2003), 68 FR 3077.

<sup>8</sup> In approving this proposed rule change, the Commission notes that it has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>9</sup> 15 U.S.C. 78f.

<sup>10</sup> 15 U.S.C. 78f(b)(6).

<sup>11</sup> 15 U.S.C. 78f(b)(7).

<sup>12</sup> 15 U.S.C. 78f(d)(1).

<sup>13</sup> 17 CFR 240.19d-1(c)(2).

<sup>14</sup> 15 U.S.C. 78s(b)(2).