

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

Nasdaq has requested that the Commission shorten the comment period and approve the filing on an accelerated basis in order to allow the listing and trading of the Notes to begin the week of August 25th, 2003. Accordingly, Nasdaq requests that the Commission find good cause pursuant to Section 19(b)(2) for approving the proposed rule change prior to the 30th day after its publication in the **Federal Register**.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act, by August 22, 2003. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. 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 such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to file number SR-NASD-2003-119 and should be submitted by August 22, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48264; File No. SR-PCX-2002-57]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Pacific Exchange, Inc., Relating to the Implementation of a New Order Audit Trail System

July 31, 2003.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 9, 2002, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the self-regulatory organization. On July 28, 2003, the Exchange filed Amendment No. 1 to the proposed rule change.³ On July 30, 2003, the Exchange filed Amendment No. 2 to the proposed rule change.⁴ The Commission is publishing the proposed rule change, as amended, to solicit comment on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange is proposing to adopt new rules relating to the creation of an order audit trail system called Electronic Order Capture System ("EOC"). The proposal will require that every member or member organization that receives an order for execution on the Exchange must immediately record the details of the order (including any modification of the terms of the order or cancellation of the order) into EOC, unless such order has been entered into the Exchange's other electronic order processing facilities.

The text of the proposed rule change is below. Additions are in *italics*; deletions are in brackets.

* * * * *

Rule 6—Options Trading Applicability, Definitions and References

Rule 6.1(a)—No change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 replaces and supersedes the original filing in its entirety.

⁴ See letter from Tania J. Cho, Staff Attorney, PCX, to Jennifer Colihan, Special Counsel, Division of Market Regulation, ("Division"), Commission, dated July 30, 2003 ("Amendment No. 2"). In Amendment No. 2, the Exchange clarified that it will not conduct an issue-by-issue roll out of the Electronic Order Capture System as originally proposed.

(b) Definitions. The following terms as used in Rule 6 shall, unless the context otherwise indicates, have meanings herein specified:

(1)–(38)—No change.

(39) *The term "Electronic Order Capture System" ("EOC") means the Exchange's electronic audit trail and order tracking system that provides a time-sequenced record of all orders and transactions on the Exchange. EOC records the receipt of an order and documents the life of the order through the process of execution, partial execution, or cancellation. This system includes the electronic communications interface between EOC booth terminals and the Floor Broker Hand Held applications. Each member's EOC booth terminal and each Floor Broker Hand Held Terminal contains an electronic order entry screen that displays the terms and conditions of each order received by that member.*

(c)–(e)—No change.

* * * * *

Admission to and Conduct on the Options Trading Floor

Rule 6.2(a)–(g)—No change.

(h)(1)–(2)—No change.

(3) Requirements and Conditions.

(A)—No change.

(B) Orders transmitted by registered Exchange Market Makers may be entered directly to the trading posts. All other orders may be entered directly to the trading posts only during outgoing telephone calls that are initiated at the option posts. *Pursuant to Rule 6.67(c), all such orders must be immediately recorded into the EOC unless there is a disruption or malfunction to the EOC, in which case the EOC Contingency Procedures will be in effect in accordance with Rule 6.67(d)(1).*

(C)—No change.

(4)—No change.

(5) Floor Brokers.

(A)–(B)—No change.

(C) Ticket to Follow. *In the event of a disruption or malfunction of EOC, pursuant to Rule 6.67(d), a [A] Floor Broker in a trading crowd may represent immediately in the trading crowd a telephonic order received from a Member or Member Firm representative located in a firm member booth [who receives a telephonic order from a Member or Member Firm representative located on the Trading Floor may represent that order immediately in the trading crowd], provided (a) that an order ticket for the order must be prepared and time stamped in the member firm booth before the order is transmitted telephonically to the Floor Broker in the trading crowd; and (b) that the written, time-stamped order ticket*

¹⁶ 17 CFR 200.30-3(a)(12).

for the order must be taken to the Floor Broker in the trading crowd immediately after it has been prepared.

(D)—No change.

(6)–(10)—No change.

Commentary

.01–.02—No change.

.03 While on the Trading Floor, clerks *must* [shall] display at all times the badge(s) supplied to them by the Exchange. [Any Market-Maker clerk who writes up an option order on the Options Floor must give his employer a copy of that order before it is delivered; the employer must retain the copy on his person until it is executed.] A clerk receiving a phone order must *immediately record the details of the order into EOC pursuant to Rule 6.67(c)*. [must initial, must mark as opening or closing and must time-stamp the order.]

.04 *For orders excepted from EOC, pursuant to Rule 6.67(d), a Market-Maker clerk who writes up an option order on the Options Floor must give his employer a copy of that order before it is delivered; the employer must retain the copy on his person until it is executed. A clerk receiving a phone order must initial, must mark as opening or closing and must time-stamp the order.*

.05[.04]—No change.

* * * * *

Fast Markets and Unusual Market Conditions

Rule 6.28(a)—No change.

(b)(1)—No change.

(2) *For orders excepted from EOC, pursuant to Rule 6.67(d), [T]he OBO may temporarily move less active issues to another post if the Book is extremely active. [Books left at the post may be separated and order shoes provided for the most active series to facilitate order flow. A special time stamp will be placed behind the Book to stamp incoming transactions before they go to Price Reporting.]*

(3)–(6)—No change.

(c)–(d)—No change.

* * * * *

Appointment of Market Makers

Rule 6.35—No change.

Commentary

.01–.03—No change.

.04 For the purposes of this rule, temporarily undertaking the obligations of a Primary Appointment with respect to non-Primary Appointment classes of option contracts at the request of an Options Floor Trading Committee member shall not be deemed trading in non-Primary Appointment classes. In addition, a Market Makers' trades

effected through a floor broker do not count for nor against the Market Maker's 75% requirement, regardless of whether the trades are in issues within or without his Primary Appointment. Also, Market Makers who are solicited on an order on behalf of an account other than that of another Market Maker may accommodate such orders, provided that the orders are clearly announced in the trading crowd as solicited, and such transactions shall not count for nor against the 75% requirement. Such orders [trades] *must* [shall] be designated by the Market Maker with an "S" in the "[o]ptional Data" field [section] of the *electronic order entry screen or, for orders excepted from EOC pursuant to Rule 6.67(d), in the "Optional Data" section of the trade ticket.*

.05—No change.

* * * * *

"Crossing" Orders and Stock/Option Orders

Rule 6.47(a)—No change.

(b) Crossing of Facilitation Orders. A Floor Broker who holds an order for a public customer of a member organization and a facilitation order may cross such orders provided that he proceeds in the following manner:

(1)—No change.

(2) [The option order tickets for both the [f]Facilitation orders and [the] customer orders *must be entered into EOC and* [display] all of the terms of such orders, including any contingencies involving, and all related transactions in, either options or underlying or related securities, *must be displayed on the electronic order screen. If facilitation orders and customer orders are excepted from EOC, pursuant to Rule 6.67(d), then order tickets must display this same information.* The Floor Broker must disclose all securities that are components of the customer order.

(3)–(6)—No change.

(c)—No change.

(1)–(3)—No change.

(4) "Solicited" *must* [shall] be *entered* [written] in the "Optional Data" field of the *electronic order entry screen or, for orders excepted from EOC pursuant to Rule 6.67(d), written in the "Optional Data" section of the trade ticket.* [area on the order ticket of the solicited order. If the solicited order is for a market maker account, the order ticket shall be personally initialed by the solicited market maker, who must have in his possession a copy of such order ticket at all times such order is active.]

(5)—No change.

(d)–(e)—No change.

(f) Stock/Option Orders. When a stock/option order is taken to a crowd for execution, the stock transaction must be effected prior to the option transaction pursuant to Rule 6.47, Commentary .04. The following procedure applies to all executions of stock/option orders: [A]after an agreement with other members of the crowd has been reached as to the terms of the transaction, the option order *must be entered into EOC or, for orders excepted from EOC, pursuant to Rule 6.67(d), written on tickets* [must be written up] and time stamped. However, the *option transaction will* [order tickets should] not be *reported to Options Price Reporting Authority ("OPRA") by EOC or, for orders excepted from EOC, pursuant to Rule 6.67(d), turned in to the Order Book Official at this time.* The members *will* [shall] attempt to immediately effect the transaction in the underlying or related security. If the stock transaction cannot be executed immediately or is effected at a price other than *an* [the] agreed-upon price, the members *will* [shall] not be held to the option transaction. If the stock transaction is effected at *an* [the] agreed-upon price, then all the members who participated in the option transaction *will* [shall] be held to their agreed-upon price. At the time the stock transaction is effected, the option *transaction must be immediately entered into EOC and reported to OPRA or, for orders excepted from EOC, pursuant to Rule 6.67(d), trade tickets must* [should] be given to the Order Book Official.

Commentary

.01–.06—No change.

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Discretionary Transactions

Rule 6.48.(a)–(b)—No change.

(c) A Market Maker shall not exercise discretion in an account unless he has a direct interest in such account. Market Makers may not exercise discretion over any account other than: a joint account approved pursuant to Rule 6.39, or an account in which the Market Maker has a direct interest. For purposes of this Rule, the term "direct interest" in an account is limited in its meaning to include only a participation in the profits and losses in such account, or in the case of a partnership or corporation, a representative of such partnership or corporation who has a supervisory responsibility over such account. Only persons registered as Market Makers and subject to the performance obligations set forth in Rule 6.37, may exercise discretion over an account.

(1) A Market Maker wishing to effect such discretionary transactions for

accounts other than the Market Maker's personal account or a joint account must enter the order with a Floor Broker and the procedures set forth in Rule 6.85. The identification of the order as a discretionary order is required pursuant to [PCX] Rule 6.68(a)(5). [(7), "Record of Orders."]

(A) *The clearing acronym* [name] of the Market Maker for whom the transaction is being executed must be [printed at the bottom of the ticket (B-6-1(c)),] *entered into EOC or, for orders excepted from EOC, pursuant to Rule 6.67(d), written on the ticket along with the clearing acronym* [badge number] of the Market Maker exercising discretion [(i.e.e.g., Joe Trader/MO7)]; and

(B) A "D" must be placed after the Market Maker's *clearing acronym* [number,] for whose account the trade is executed[, in the firm box (e.g., MO5 D)].

Solicited Transactions

Rule 6.49(a)-(b)—No change.

(c) "Solicited" *must* [shall] be *entered* [written] in the "Optional Data" *field of the electronic order entry screen for* [area on the order ticket of] the Solicited order. *For orders excepted from EOC, pursuant to Rule 6.67(d), "Solicited" must be written in the "Optional Data" section on the order ticket of the Solicited order.*

* * * * *

ORDER BOOK OFFICIALS

Order Book Official Defined

Obligations for Orders

Rule 6.52(a)-(d)—No change.

Commentary

.01.—.03—No change.

.04 For purposes of this Section, orders *excepted from EOC, pursuant to Rule 6.67(d)*, will be within the custody of Order Book Officials only when they have been deposited, properly time-stamped and marked, in the proper receptacle.

.05—No change.

* * * * *

Certain Types of Orders Defined

Rule 6.62(a)-(b)—No change.

(c) A contingency order is a limit or market order to buy or sell that is contingent upon a condition being satisfied. [while the order is at the Post.]

(d)—No change.

(e) Not held order. *A not held order is an order that provides a broker with discretion as to price or time in executing the order. A "not held" order must be designated as such in the "Optional Data" field of the electronic order entry screen. For orders excepted*

from EOC, pursuant to Rule 6.67(d), a [A] not held order [is an order that] is marked "not held", "NH", "take time" or *marked with some* [that bears any] qualifying notation giving discretion as to the price or time at which such order is to be executed. The "not held" designation must appear in the "special instructions" portion of the order ticket. Orders that merely include a "not held" designation as part of the time stamp will not be deemed to be "not held" orders.

(f)-(j)—No change.

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Order Format and System Entry Requirements

[Orders Required To Be in Written Form]

Rule 6.67(a). Transmitted to the Floor. Each order transmitted to the Floor must be recorded legibly in a *format* [written form] that has been approved by the Exchange, and the member receiving such order must record the time of its receipt on the Floor. Each such order must be in a *legible format* [written form] when *transmitted* [taken] to the post for attempted execution. Orders sent electronically through the Exchange's Member Firm Interface or orders entered into the Exchange's EOC are [deemed to be written] *approved formats for transmitting orders* for purposes of Rule 6.67.

(b) *Order Format Requirements. Orders sent to the Exchange for execution must comply with the order format requirements established by the Exchange relating to, among other things, option symbol, expiration month, exercise price, type of option (call or put), quantity of option contracts, clearing member organization, whether the order is to buy or sell, and whether the order is market or limit.*

[(b) Cancellations and changes. Each cancellation of, or change to, an order that has been transmitted to the Floor must be recorded legibly in a written form that has been approved by the Exchange, and the member receiving such cancellation or change must record the time of its receipt on the Floor.]

(c) *EOC Entry Requirement. Every member or member organization that receives an order for execution on the Exchange must immediately record the details of the order (including any modification of the terms of the order or cancellation of the order) into EOC, unless such order has been entered into the Exchange's other electronic order processing facilities (e.g., orders sent electronically through the Exchange's Member Firm Interface). The details of*

each order required to be recorded upon receipt must include the data elements prescribed in Rule 6.68(a)(1) through (9), and such other information as may be required by the Exchange from time to time.

[(c) Executions. A member transmitting from the Floor a report of the execution of an order must record the time at which a report of such execution is received by such member.]

(d) *Exceptions to EOC Entry Requirement. The EOC entry requirement provision of subsection (c) will not apply during any disruption or malfunction of EOC or any Exchange system relied on by a Floor member to record the details of an order.*

[(d) A Floor Broker may represent a telephonic order, with the ticket to follow, as provided in Rule 6.2(h)(4)(C).]

(1) *EOC Contingency Procedures. In the event of an EOC system disruption or malfunction, the EOC entry requirement will be suspended upon approval by two Floor Officials. At this time, member firms shall use a backup supply of tickets to record the details of all orders received through non-electronic means. All order events (i.e., receipt, changes, execution, partial execution, cancellation, or nothing done) must be immediately time stamped (a time stamp synchronized with the atomic clock will be available at all trading posts). During such circumstances, existing rules on manual processing of order tickets are applicable. Once the disruption or malfunction to the EOC system has been corrected, as determined by two Floor Officials, all member firms must input all orders into an EOC device via the "as-of" field, noting the times of events of the orders. Any member firm who fails to follow such procedures will be subject to disciplinary action pursuant to Rule 10.*

(e) *Hand Signals. The following regulations govern the proper use of hand signals on the Options Trading Floor: [(1)] Hand signals may always be used to request and to relay information regarding current quotations and market size. Hand signals may also be used to increase or decrease the size of an order, to change the order's limit, to cancel an order or to activate a market order.*

(1) *EOC Eligible Orders. Any cancellation of or change to an order relayed to a Floor Broker through the use of hand signals must be entered into EOC [also must be relayed to the Floor Broker in a time stamped, written form immediately thereafter]. All cancellations and changes of orders held by the Order Book Official must be immediately submitted electronically. [in written form. Executing brokers who*

receive such communications must have a written order in their possession with all of the following information on the ticket:]

(2) *Orders Excepted from EOC*
Pursuant to Rule 6.67(d). Executing brokers who receive any cancellation of or change to an order relayed to a Floor Broker through the use of hand signals must be relayed to the Floor Broker in a time stamped, written form immediately thereafter. All cancellations and changes of orders held by the Order Book Official must be in written form. Executing brokers who receive such communications must have a written order in their possession with all of the following information on the ticket:

Underlying security ticker symbol

Expiration month

Striking price

Volume

Purchase or Sale Notation

Whether Market or Limit Order

(A)[(2)] Cancellation of orders held by the Floor Broker must be in written form in accordance with current practice. A Floor Broker may cancel an order through the use of hand signals if it is followed immediately by written cancellation.

(B)[(3)] Any change to an order must be documented in writing outside of the crowd and the ticket time-stamped, before the revised order may be represented.

(f) Any member desiring to use an order form in a format other than that provided by the Exchange must submit such form to the Options Floor Trading Committee and obtain its approval prior to using such form on the Floor.]

(f) *The system entry requirement prescribed in subsection (c), above, will be operative on or before August 29, 2003.*

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Record of Orders

Rule 6.68(a). Every member organization *must* [shall] maintain and preserve for the period specified under SEC Rule 17a-4, a [written] record of every order and of any other instruction given or received for the purchase or sale of option contracts. Such record *must* [shall] show the terms and conditions (market order, limit order, etc.) of the order or instruction and of any modification or cancellation thereof, and in addition *must* [shall] include:

[(1) The account designation for which such order is to be executed;

(2) the date and time stamp indicating the time the order was entered and executed or cancelled;

(3) the type of option and the underlying stock;

(4) the expiration month, the exercise price, the number of option contracts and the execution price (premium);

(5) whether the order is a purchase or a sale (writing) and whether the order is an opening or a closing transaction;

(6) whether the order is solicited or unsolicited; and

(7) whether the order is discretionary.]

(1) *Clearing member organization;*

(2) *Option symbol, expiration month, exercise price, and type of option (call or put);*

(3) *Side of market (buy or sell);*

(4) *Quantity of option contracts;*

(5) *Any limit price, stop price, or special conditions;*

(6) *Opening or closing transaction;*

(7) *Time in force;*

(8) *Account origin code;*

(9) *Solicited or unsolicited;*

(10) *Order identification number;*

(11) *Order entry date and time, or the date and time of any modification of the terms of the order or cancellation of the order;*

(12) *Order execution time and price;*

(13) *Identity of the executing broker and the other party to the transaction; and*

(14) *Such other information as may be required by the Exchange.*

(b) *EOC Record Retention. Members and member organizations will comply with their record keeping obligations under this Rule by immediately entering orders upon receipt (including any modifications and cancellations) into EOC or the Member Firm Interface and retaining the record of such orders.*

(c) *Record Retention for Orders Excepted from EOC Pursuant to Rule 6.67(d).* In addition to the white (control) copy, and/or hard copy, which must be kept for the entire amount of time specified in Securities Exchange Act Rule 17a-4, the green (commission) copy must also be retained for a minimum of 48 hours from the trade date. In the case of those orders executed by independent Floor Brokers, it is their responsibility to retain the green (commission) copy, and the executing member firm must retain the white or hard copy. Also, all such records must be readily available for use on the trading floor for the resolution of any problems relating to the execution of these orders.

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Reporting Duties

Rule 6.69(a)–(e)—No change.

Commentary

.01 *EOC Reporting Procedure.* The Options Floor Trading Committee has

established the following procedure for reporting of transactions pursuant to Rule 6.69. For each transaction on the Exchange in which a *member* [he] participates as seller, *that* [a floor] member *will* [shall] immediately record into EOC, [on a card or ticket in a form acceptable to the Committee his] *its* assigned broker initial code, the symbol of the underlying security, the type, expiration month and exercise price of the option contract sold, the transaction price, the number of contract units comprising the transaction, the name of the contra clearing member, and the assigned broker initial code of the contra member. Members *must report any* [shall identify price reporting tickets which represent the] partial execution of a larger order into EOC [the manner prescribed by the Exchange. The card or ticket for a] Any agency order *must* [shall] also include the account origin code[.]. [as set forth in Commentary .02 below. This reporting card or ticket shall immediately be time-stamped at the station where option contracts of the class involved are traded and attached to the appropriate “buy” ticket. The card or ticket shall then be placed in the price reporting card box provided at the station. Before placing the tickets in the box, the member shall use his best efforts to make sure that the Order Book Official with respect to option contracts of the class involved, or the Order Book Official clerk, is aware of the transaction and its price. In transactions when the buyer accepts tickets from the seller(s), it shall be the buyer’s responsibility to time-stamp the tickets, use best efforts at securing the Order Book Staff’s attention to the transaction, and submit the tickets into the box.] Any floor member failing to immediately report a transaction in accordance with Rule 6.69 *will* [shall] be subject to [being fined] *disciplinary action pursuant to Rule 10.* [by the Options Floor Trading Committee.]

.02 *Reporting Procedures for Orders Excepted from EOC Pursuant to Rule 6.67(d).* The Options Floor Trading Committee has established the following procedure for reporting of transactions pursuant to Rule 6.69. For each transaction on the Exchange in which a *member* participates as seller, *that floor member will immediately record, on a card or ticket in a form acceptable to the Committee, its assigned broker initial code, the symbol of the underlying security, the type, expiration month and exercise price of the option contract sold, the transaction price, the number of contract units comprising the transaction, the name of the contra*

clearing member, and the assigned broker initial code of the contra member. Members must identify price reporting tickets that represent the partial execution of a larger order in the manner prescribed by the Exchange. The card or ticket for any agency order must also include the account origin code, as set forth in Commentary .03 below. This reporting card or ticket shall immediately be time-stamped at the station where option contracts of the class involved are traded and attached to the appropriate "buy" ticket. The card or ticket shall then be placed in the price reporting card box provided at the station. Before placing the tickets in the box, the member shall use his best efforts to make sure that the Order Book Official with respect to option contracts of the class involved, or the Order Book Official clerk, is aware of the transaction and its price. In transactions when the buyer accepts tickets from the seller(s), it shall be the buyer's responsibility to time-stamp the tickets, use best efforts at securing the Order Book Staff's attention to the transaction, and submit the tickets into the box. Any floor member failing to immediately report a transaction in accordance with Rule 6.69 will be subject to disciplinary action pursuant to Rule 10.

[.02 Reporting of Trade Information. The responsibility for time stamping and reporting of trades to the Order Book is as follows:

(a) One buyer, multiple sellers—responsibility is with the buyer

(b) one seller, multiple buyers—responsibility is with the seller

(c) one buyer, one seller—responsibility is with the seller]

.03 *Origin Codes for Orders Excepted from EOC Pursuant to Rule 6.67(d).* For purposes of Rule 6.69(d), trade information includes the proper account origin codes, which are as follows: "C" for non-broker-dealer customer accounts; "F" for firm proprietary accounts; "M" for member Market Maker accounts; and "B/D" for firm orders of non-member broker-dealer accounts, stock specialist accounts, or customer account trades of the broker-dealer or non-member broker-dealer. In addition, Market Maker clearing firms are directed to instruct their respective trading desks to identify Market Maker orders that are entered from off the floor and not entitled to Market Maker margin treatment by placing a "C" after the Market Maker's number in the "firm" box on the ticket. Floor Brokers, when accepting an order by phone from a Market Maker, are similarly directed to identify that order in the same manner.

.04—No change.

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Priority and Order Allocation Procedures

Rule 6.75(a)–(h)—No change.

Commentary

.01–.03—No change.

.04 *Combination, Spread and Straddle Orders.* Following are the proper trading procedures for combination, spread and straddle orders:

(a) *Announcing the Order.* Any member holding a combination, spread, or straddle order must [write it on one ticket and must] bid or offer for each series in the order. *For orders excepted from EOC, pursuant to Rule 6.67(d), such orders must be written on a ticket.* The member may express the order as it applies to each separate series or may express the order at its total or net debit/credit alone, so long as it is clear that the member is attempting to execute both series as a combination, spread, or straddle. The executing member must ensure that the trading crowd is aware of the request for a market and has an opportunity to participate in the transaction.

(b)–(g)—No change.

* * * * *

Joint Accounts

Rule 6.84(a)–(h)—No change.

Commentary

.01–.02—No change.

.03 *Transactions on the Floor will be presumed to be for the proprietary account of the individual members unless the executing member enters the joint account symbol into EOC. For orders excepted from EOC, pursuant to Rule 6.67(d), transactions on the Floor will be presumed to be for the proprietary account of the individual members unless the joint account symbol is given up and used on the trade ticket to represent the joint account as the executing member.*

.04 Any order of a joint account participant[,] *that* [which] is executed by a Floor Broker, *must* [shall] be in accordance with the procedures set forth in Rule 6.85, except that the joint account trading number with its alpha identification *must be entered into EOC, or, for order excepted from EOC, pursuant to Rule 6.67(d), the joint account trading number with its alpha identification must* [should] appear in the "executing firm" area. Additionally, a joint account may not bid, offer, purchase, sell, or enter orders in an option series in which a Floor Broker holds an order on behalf of the joint

account or for the proprietary account of another participant in the joint account. Orders of joint account participants in a particular option series may not be concurrently represented[,] by one or more Floor Brokers.

.05–.07—No change.

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Market Maker Orders Executed By Floor Brokers

Rule 6.85(a)–(c)—No change.

Commentary

.01–.02—No change.

.03 *Orders Excepted from EOC Pursuant to Rule 6.67(d).* Market Maker order tickets should be prepared by the Market Maker, when possible. All orders *must* [shall] be recorded and time-stamped, pursuant to Rule 6.67. Order tickets *must* [shall] include the acronym of the Market Maker entering the order in the area marked "buying firm/selling firm," with the Market Maker's name printed at the bottom of the ticket. Order tickets must be marked to indicate whether the order is "GTC" or day only. The acronym of the executing Floor Broker *must* [shall] be written in the area marked "executing member." When utilizing a "partial order" ticket to facilitate the completion of an order, the control number of the original order ticket must be written on the partial order ticket.

Except as provided in Rule 6.2(h)(5)[(4)](C) (Ticket to Follow Rule), when a Floor Broker receives a verbal order from a Market Maker, or when a Floor Broker is requested by a Market Maker to alter an order in his possession in any way, the Floor Broker *must* [shall] immediately prepare an order ticket from outside the trading crowd and timestamp it.

* * * * *

Floor Broker Hand-Held Terminals

Rule 6.89(a)—No change.

(b) *Proprietary Brokerage Order Routing Terminals:*

(1)–(3)—No change.

(4)(A)—No change.

(B) *Orders Excepted from EOC Pursuant to Rule 6.67(d).* When a Member executes an order that was received over a Terminal, the Member must fill out and *immediately* time stamp a trading ticket [within one minute of the execution]. Exchange rules on record keeping and trade reporting are unchanged.

(C)–(D)—No change.

(5)–(7)—No change.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B and C below, of the most significant aspects of such statements.

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

1. Purpose

Background

The Exchange is proposing to effect rule changes to support the implementation of its new audit trail system known as Electronic Order Capture System ("EOC").⁵ EOC is intended to fulfill one of the undertakings contained in the Commission's Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions. ("Order").⁶ Specifically, this rule filing is intended to respond to Section IV.B.e.(v) of the Order, which requires, among other things, that the PCX incorporate into its audit trail all non-electronic orders such that the audit trail provides an accurate, time-sequenced record of electronic and other orders, quotations and transactions, beginning with the receipt of the order and documenting the life of the order through the process of execution, partial execution, or cancellation.⁷

Currently, the PCX operates an electronic order routing and execution system called Pacific Options Exchange Trading System ("POETS"),⁸ and

several other peripheral systems including the Pacific Options Processing System ("POPS")⁹ and the Floor Broker Hand Held trading system,¹⁰ in conjunction with traditional open outcry trading with Floor Brokers and competing Market Makers. The Exchange's Member Firm Interface ("MFI") enables Member Firms to send orders electronically to the Exchange for delivery to either POETS, a Floor Broker Hand Held Terminal, or to a Member Firm's default destination.¹¹ While all executions using POETS and electronic hand-held devices carry immediately assigned system times, orders that are routed to the Floor by telephone or sent to Member Firm printers located on the Floor generally require manual trade ticket processing. Under the proposal, EOC will eliminate the manual processing of order tickets and will further facilitate the creation and development of a comprehensive audit trail and automated surveillance systems.

Summary of Proposed Rule Changes

The Exchange is proposing to adopt a number of changes to its rules regarding the record of orders (principally PCX Rules 6.67 and 6.68) to enhance the Exchange's audit trail and self-regulatory capabilities. The proposed changes to the text of the PCX rules are summarized below.

(1) *Electronic Order Capture System ("EOC")*

EOC is the Exchange's proposed electronic audit trail and order tracking system that will provide a time-sequenced record of all orders and transactions on the Exchange.¹² EOC will record the receipt of an order and will document the life of the order through the process of execution, partial execution, or cancellation. This system includes the electronic communications interface between EOC booth terminals and the Floor Broker Hand Held

system, an automatic execution system ("Auto-Ex"), an on-line limit order book system ("Auto-Book"), and an automatic market quote update system ("Auto-Quote").

⁹ POPS is the Exchange's automated system that compares trade information entered by Member Firms and submits trades to the Options Clearing Corporation for clearance and settlement.

¹⁰ The Floor Broker Hand Held interface is an automated order delivery system that enables Floor Brokers to receive and execute orders electronically, and to report trade executions to the tape via the Options Price Reporting Authority ("OPRA") and to POPS for clearing. See PCX Rule 6.89.

¹¹ A Member Firm's default destination may be either a particular firm booth or a remote entry site, to which orders that fail to meet the eligibility criteria necessary for Auto-Ex or Auto-Book will be delivered.

¹² See proposed PCX Rule 6.1(b)(39) (definition of "Electronic Order Capture System").

Terminal applications. Each Member's EOC booth terminal and each Floor Broker Hand Held Terminal will contain an electronic order entry screen that displays the terms and conditions of each order received by that Member.

The Exchange is proposing to adopt new PCX Rule 6.67(c),¹³ which requires that every Member or Member Organization that receives an order for execution on the Exchange must immediately¹⁴ record the details of the order (including any modification of the terms of the order or cancellation of the order) into EOC, unless such order has been entered into the Exchange's other electronic order processing facilities¹⁵ (e.g., orders sent electronically through the Exchange's MFI).¹⁶ The details of each order that will be required to be recorded upon receipt include the following:¹⁷ (1) Clearing member organization; (2) Option symbol, expiration month, exercise price, and type of option (call or put); (3) Side of market (buy or sell); (4) Quantity of option contracts; (5) Any limit price, stop price, or special conditions; (6) Opening or closing transaction; (7) Time in force; (8) Account origin code; and (9) Solicited or unsolicited.¹⁸

Member Firms may comply with the proposed rule in one of three ways: (1) Required order details may be transmitted via the Exchange's other electronic order processing facilities that electronically assign the time of receipt on the Exchange; (2) Order details may be routed to the Member

¹³ Former PCX Rules 6.67(b), (c) and (d) are being deleted as they are redundant and superfluous provisions pursuant to proposed PCX Rules 6.67(c), 6.67(d) and 6.67(d)(1).

¹⁴ The Exchange commits that it will implement proactive and effective surveillance procedures for violations of Exchange rules and federal securities laws, including, but not limited to, rules prohibiting trading ahead and front running, related to the entry of customer orders into the EOC system.

¹⁵ The EOC entry requirement will also apply to PCX Plus.

¹⁶ The systemic entry requirement would not be applicable to transactions initiated on the Floor and executed by a registered Market Maker or a Lead Market Maker for their own account, as such trades that may be initiated on the Floor and that are already reported to POETS via proprietary hand-held devices.

¹⁷ The Exchange notes that the order entry time and identification number are automatically assigned upon entry into EOC. Further, the Exchange notes that certain data elements tied to execution, such as executing broker, contra broker, execution time and price are not available at the time that order details are entered into EOC. This information will be captured automatically by EOC at the time of execution of an order. Telephone call between Peter D. Bloom and Tania J. Cho, Attorneys, PCX, and Jennifer Colihan, Special Counsel, Division, Commission, on July 29, 2003.

¹⁸ The proposed rule also includes a provision that would require Member Firms to record such other information as may be required by the Exchange from time to time.

⁵ PCX is currently working with the other options exchanges through the Intermarket Surveillance Group ("ISG") in the design and implementation of the Consolidated Options Audit Trail System ("COATS"). Upon its completion, COATS is expected to be a fully integrated intermarket audit trail using quote and trade data from all the options exchanges. EOC is a project specific to PCX and it will contain certain trade information for inclusion into COATS.

⁶ See Securities Exchange Act Release No. 43268 (September 11, 2000) and Administrative Proceeding File No. 3-10282.

⁷ *Id.* at 13-14.

⁸ POETS is the Exchange's automated trading system comprised of an options order routing

Firm booth by telephone or be sent to the Member Firm's printer located on the Floor, and immediately entered into the EOC booth device, which will electronically assign the time of receipt on the Exchange; or (3) Orders may be received during outgoing telephone calls that are initiated at the option post, and then immediately entered into the EOC booth device, which will electronically assign the time of receipt on the Exchange pursuant to PCX Rule 6.2(h)(3)(B).¹⁹ The EOC booth device that is used to record the details of the order upon receipt on the Floor is an Exchange provided system.²⁰ The EOC booth device and the enhancements to the existing Floor Broker Hand Held Terminal applications will support the entry of all order types (including contingency and complex orders, *i.e.*, multiple-leg option and stock/option orders) and all required information, as well as provide quick entry templates to speed data entry. Once a Member Firm's booth clerk records the details of an order into EOC or in the case when a Floor Broker receives an order pursuant to PCX Rule 6.2(h)(3)(B), the order is routed electronically to a Floor Broker Hand Held Terminal for representation in the trading crowd.²¹ Member Firms will have the capability to track and display all orders that are submitted through the EOC booth device, as all orders will be assigned an unique identifier that will be used throughout the life of the order.

Once an order has been executed, the Floor Broker Hand Held Terminal system will route trade information to POETS (via the EOC interface), which will then route the information to POPS for trade match and clearing purposes. At the same time, the Exchange will send a report to the Member Firm that entered the order and will transmit trade information to OPRA.

The Exchange believes that the implementation of EOC, as described above, will improve order information management features resulting in operational efficiencies for Member Firms.

¹⁹ The Exchange's order processing systems have been designed so that the clocking mechanisms do not deviate by more than three seconds from the Naval Observatory atomic clock in Washington, D.C.

²⁰ The EOC will not initially support the use of a Member Firm's proprietary system to comply with the proposed order entry requirements.

²¹ Orders sent via the EOC interface to a Floor Broker in the trading crowd may subsequently be transmitted electronically to another Floor Broker on the Floor. When an order is transmitted from one Member to another, the EOC will capture each phase of processing as the order moves from entry to execution.

(2) Order Format Requirements

The Exchange's current rules governing the order format requirements in transmitting orders to the Exchange are set forth in PCX Rule 6.67(a). The Exchange is proposing to add interpretive language to make it clear that EOC is an approved format for transmitting orders for purposes of this Rule. In addition, proposed PCX Rule 6.67(b) requires that orders sent to the Exchange for execution must comply with the order format requirements established by the Exchange relating to, among other things, option symbol, expiration month, exercise price, type of option (call or put), quantity of option contracts, clearing member organization, whether the order is to buy or sell, and whether the order is market or limit.

(3) Exceptions to EOC Entry Requirement

An exception to the requirement for recording order information into EOC is contained in proposed PCX Rule 6.67(d). Under this proposed rule, if a disruption or malfunction to EOC or any other Exchange electronic order processing system occurs, the EOC entry requirement will be suspended upon the approval of two Floor Officials, and the EOC Contingency Procedures will be in effect pursuant to PCX Rule 6.67(d)(1).²² If the Exchange is still able to process and disseminate quotes accurately, then any orders received by the Exchange will be processed manually through the use of paper tickets. In such circumstances, all other Exchange rules governing options trading will remain in effect. Accordingly, the Exchange intends to retain its existing rules that are applicable to the manual processing of order tickets. Minor changes have been made throughout the existing options trading rules to allow for manual processing of trade tickets when necessary.

(4) Record of Orders

Current PCX Rule 6.68(a) requires Member Organizations to maintain and preserve certain information items relating to the terms of each option order. The Exchange is proposing to make minor technical changes to the text by renaming and renumbering certain information items enumerated in the Rule for clarity. The proposed rule change does not replace existing

²² Under the proposed rule, member firms must use a backup supply of tickets to record the details of the order received through non-electronic means and time stamp the order of events. Once the disruption or malfunction has been corrected, as determined by two Floor Officials, member firms must input all orders into an EOC device using the "as-of" field.

requirements for recording orders contained in this Rule.

The Exchange is also proposing to add new PCX Rule 6.68(b) to make it clear that Members and Member Organizations must comply with their record keeping obligations under this Rule by immediately entering orders upon receipt (including any modifications and cancellations) into EOC or the MFI and retaining the record of such orders.²³

(5) Reporting of Trade Information

The Exchange proposes to rescind current PCX Rule 6.69, Commentary .02, which relates to the trade reporting requirements of Members. The Exchange believes that this rule is superfluous and that it is inconsistent with PCX Rule 6.69(b), which already requires that the Member representing the sell side of a transaction is responsible for reporting the transaction to the Exchange in a form and manner prescribed by the Exchange. Therefore, because current PCX Rule 6.69(b) accurately reflects the PCX's existing trade reporting requirements, the Exchange is proposing to eliminate Commentary .02 of this rule for clarity.

Proposed new PCX Rule 6.69, Commentary .02 specifies the reporting procedures for orders that are manually processed when there is a disruption or malfunction with the EOC pursuant to PCX Rule 6.67(d). This proposed new rule was adapted from current PCX Rule 6.67, Commentary .01.

(6) Implementation Date

The system entry requirement proposed in this rule change will be operative on or before August 29, 2003.²⁴ This date is consistent with the extension deadline provided by the Commission to the PCX (and other respondent exchanges) for compliance with Section IV.B.e.(v) of the SEC Order to incorporate into the audit trail all non-electronic orders.²⁵

(7) Miscellaneous Changes

The Exchange proposes to make several minor, non-substantive changes to the text of several existing PCX Rules to correct stylistic, grammatical and typographical errors and to conform the

²³ Former PCX Rule 6.68(b) is being renumbered as new Rule 6.68(c).

²⁴ See proposed PCX Rule 6.67(f).

²⁵ See Letter from Annette L. Nazareth, Director, Division of Market Regulation, Stephen M. Cutler, Director, Division of Enforcement, and Lori A. Richards, Director of Office of Compliance Inspections and Examinations, Securities and Exchange Commission to Kathryn L. Beck, Pacific Exchange, Inc., dated June 10, 2003.

proposed rules to the new EOC requirements.²⁶

2. Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b)²⁷ of the Act, in general, and further the objectives of Section 6(b)(5),²⁸ in particular, because it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments and perfect the mechanisms of a free and open market and to protect investors and the public interest. In addition, the Exchange believes that the proposed rule change is consistent with provisions of Section 11A(a)(1)(B) of the Act,²⁹ which states that the new data processing and communications techniques create the opportunity for more efficient and effective market operations.

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

The Exchange does not believe that the proposed rule change will impose 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

Written comments on the proposed rule change were neither solicited nor received.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

A. By order approve such proposed rule change, or

B. Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing,

including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. 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 such filing will also be available for inspection and copying at the principal office of the PCX. All submissions should refer to File No. SR-PCX-2002-57 and should be submitted by August 28, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.³⁰

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48266; File No. SR-Phlx-2003-56]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval to Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to a Pilot Program to Deploy the Options Floor Broker Management System

July 31, 2003.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on July 31, 2003, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Phlx. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and to approve the proposal, on an accelerated

basis. The pilot will expire on August 29, 2003.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to effect a pilot program to deploy a new component of the Exchange's Automated Options Market (AUTOM) and Automatic Execution System (AUTO-X)³ by adopting new Phlx Rules 1063(e) and 1080, Commentary .06 relating to the Exchange's Options Floor Broker Management System (the "System") on a pilot basis beginning not later than July 31, 2003, extending through full deployment of the System not later than August 29, 2003 ("the pilot").

In order to have enforceable rules in place concerning the System, and to ensure that Floor Brokers using the System during the month-long deployment would not be in violation of current Exchange rules concerning ticket marking requirements, the Exchange proposes that the following rule text, which would apply to Floor Brokers using the System during the pilot, become effective on a pilot basis, to expire on August 29, 2003.⁴

The text of the proposed rule change is set forth below. New text is in *italics*; deletions are in *brackets*.

* * * * *

Obligations And Restrictions Applicable To Specialists And Registered Options Traders

Rule 1014.

(a)-(f) No change.

(g) Equity Option and Index Option Priority and Parity

(i)(A) Exchange Rules 119 and 120 direct members in the establishment of priority of orders on the floor. In addition, equity option and index option orders of controlled accounts are required to yield priority to customer

³ 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.

⁴ The Exchange has filed for permanent approval of the proposed rules. See SR-Phlx-2003-40 and Amendment No. 1 thereto. The Exchange acknowledges that SR-Phlx-2003-40 and Amendment No. 1 thereto will be subject to publication of a Notice in the **Federal Register** and subject to public comment, which may result in amendments to the proposed rules.

²⁶ See e.g., proposed PCX Rules 6.48 and 6.62(e).

²⁷ 15 U.S.C. 78f(b).

²⁸ 15 U.S.C. 78f(b)(5).

²⁹ 15 U.S.C. 78k-1(a)(1)(B).

³⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.