

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-49697; File No. SR-Phlx-2004-18)

May 13, 2004

Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. to Make Permanent a Pilot Program Relating to the Book Sweep Function of the Exchange's Automated Options Market System

I. Introduction

On March 1, 2004, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange"), filed with the Securities and Exchange Commission ("Commission") a proposed rule change 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> to make permanent a pilot program relating to a current enhancement to the Exchange's Automated Options Market ("AUTOM") System,<sup>3</sup> which is designed to automatically execute limit orders on the book when the bid or offer generated by the Exchange's Auto-Quote<sup>4</sup> system (or by a proprietary quoting system called "Specialized Quote Feed" or "SQF")<sup>5</sup> locks or crosses a limit order on the book, thus rendering such limit order marketable. The proposed rule change

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

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

<sup>3</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 features. 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>4</sup> Auto-Quote is the Exchange's electronic options pricing system, which enables specialists to automatically monitor and instantly update quotations. See Exchange Rule 1080, Commentary .01(a).

<sup>5</sup> See Exchange Rule 1080, Commentary .01(b)(i).

was published for comment in the Federal Register on March 11, 2004.<sup>6</sup> The Commission received no comments on the proposal. This order approves the proposed rule change.

## II. Description

On September 29, 2003, the Commission approved a six-month pilot enhancement to the Exchange's AUTOM system, called Book Sweep.<sup>7</sup> The Book Sweep pilot was subsequently extended until the earlier of July 1, 2004 or such time as the Commission approves the Book Sweep feature on a permanent basis.<sup>8</sup> The Exchange now seeks permanent approval of the Book Sweep pilot.

Book Sweep allows certain orders resting on the limit order book<sup>9</sup> to be automatically executed when the bid or offer generated by the Exchange's Auto-Quote system (or by the SQF) locks (i.e., \$1.00 bid, \$1.00 offer) or crosses (i.e., \$1.05 bid, \$1.00 offer) the Exchange's best bid or offer in a particular series as established by an order on the limit order book. Orders executed by the Book Sweep feature are allocated among crowd participants participating on the Wheel.<sup>10</sup> If Book Sweep is not engaged at the time the Auto-Quote or SQF bid or offer matches or crosses

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<sup>6</sup> See Securities Exchange Act Release No. 49365 (March 4, 2004), 69 FR 11690.

<sup>7</sup> See Securities Exchange Act Release No. 48563 (September 29, 2003), 68 FR 57724 (October 6, 2003) (SR-Phlx-2003-30).

<sup>8</sup> See Securities Exchange Act Release No. 49459 (March 23, 2004), 69 FR 16629 (March 30, 2004) (SR-Phlx-2004-21).

<sup>9</sup> The electronic "limit order book" is the Exchange's automated specialist limit order book, which automatically routes all unexecuted AUTOM orders to the book and displays orders real-time in order of price-time priority. Orders not delivered through AUTOM may also be entered onto the limit order book. See Exchange Rule 1080, Commentary .02.

<sup>10</sup> The "Wheel" is a feature of AUTOM that allocates contra-party participation respecting automatically executed trades among the specialist and registered options traders signed onto the Wheel for that listed option. See Exchange Rule 1080(g). See also Option Floor Procedure Advice F-24.

the Exchange's best bid or offer as represented by a limit order on the book,<sup>11</sup> the specialist may manually engage Book Sweep so that certain orders in the limit order book can be automatically executed. Prior to the deployment of Book Sweep, when the Auto-Quote or SQF bid or offer locked or crossed a booked order, the specialist handled the execution manually after being alerted by the system that one or more limit orders on the book have become marketable and are due an execution.

### III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, the requirements of Section 6 of the Act.<sup>12</sup> Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act, which requires that the rules of a national securities exchange be designed to promote just and equitable principles of trade, as well as to remove impediments to and perfect the mechanism of a free and open market, and, in general, to protect investors and the public interest.<sup>13</sup>

The Commission notes that permanent approval of Book Sweep, which has been operating on a pilot basis for over six months, should help facilitate the more efficient execution of orders when Auto-Quote or SQF locks or crosses the Exchange's best bid or offer in a series, as established by an order on the limit order book. The Commission notes that the Exchange's Book Sweep system is similar to systems that the Commission has previously approved for use

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<sup>11</sup> Book Sweep would be engaged when AUTO-X is engaged, and would be disengaged when AUTO-X is disengaged. See Exchange Rule 1080(c)(iii).

<sup>12</sup> In approving the proposal, the Commission has considered the rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>13</sup> 15 U.S.C. 78f(b)(5).

on other exchanges.<sup>14</sup> In addition, the Commission notes that the proposed rule change does not alter Phlx members' duty to comply with the Commission's rule relating to the firmness of quotations.<sup>15</sup> The trading crowd, as the responsible broker or dealer, would continue to be required to honor its disseminated quote.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>16</sup> that the proposed rule change (SR-Phlx-2004-18) be, and it hereby is, approved on a permanent basis.

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

J. Lynn Taylor  
Assistant Secretary

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<sup>14</sup> See, e.g., Securities Exchange Act Release No. 44462 (June 21, 2001), 66 FR 34495 (June 28, 2001) (SR-CBOE-00-22) (Order approving CBOE Autoquote Triggered EBook Execution system).

<sup>15</sup> 17 CFR 240.11Ac1-1.

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

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