

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45758; File No. SR-Phlx-2001-40]

### Self-Regulatory Organizations; Order Approving a Proposed Rule Change and Amendment Nos. 1, 2, 3, and 4 Thereto and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 5 Thereto by the Philadelphia Stock Exchange, Inc. Establishing a Six-Month Pilot Program Relating to Broker-Dealer Access to AUTOM

April 15, 2002.

#### I. Introduction

On May 2, 2001, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with 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 Exchange Rule 1080, Philadelphia Stock Exchange Automated Options Market ("AUTOM") and Automated Execution System ("AUTO-X"), to permit access to AUTOM, the Exchange's options order routing, delivery, execution and reporting system, to off-floor broker-dealers on a six-month pilot basis. On July 26, 2001, the Exchange filed Amendment No. 1<sup>3</sup> to the proposed rule change with the Commission. On November 29, 2001, the Exchange filed Amendment No. 2<sup>4</sup> to the proposed rule change with the Commission. On February 1, 2002, the Exchange filed Amendment No. 3<sup>5</sup> to the proposed rule change with the Commission. On February 20, 2002, the Exchange filed Amendment No. 4<sup>6</sup> to the proposed rule change with the Commission. The substance of these Amendments was described in the notice of this proposed rule change, which was published for comment in the **Federal Register** on

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

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

<sup>3</sup> See letter to Nancy J. Sanow, Senior Special Counsel, Division of Market Regulation ("Division"), SEC, from Richard S. Rudolph, Counsel, Phlx, dated July 25, 2001 ("Amendment No. 1").

<sup>4</sup> See letter to Nancy J. Sanow, Senior Special Counsel, Division, SEC, from Richard S. Rudolph, Counsel, Phlx, dated November 28, 2001 ("Amendment No. 2").

<sup>5</sup> See letter to Nancy J. Sanow, Senior Special Counsel, Division, SEC, from Richard S. Rudolph, Counsel, Phlx, dated January 31, 2002 ("Amendment No. 3").

<sup>6</sup> See letter to Nancy J. Sanow, Senior Special Counsel, Division, SEC, from Richard S. Rudolph, Counsel, Phlx, dated February 19, 2002 ("Amendment No. 4").

March 7, 2002.<sup>7</sup> No comments were received on the proposed rule change. On April 15, 2002, the Exchange filed Amendment No. 5<sup>8</sup> to the proposed rule change with the Commission. This order approves the proposed rule change, as amended, for a pilot period of six months through October 15, 2002, and issues notice of filing and approves Amendment No. 5 to the proposed rule change on an accelerated basis.

#### II. Description of the Proposal

Exchange Rule 1080 governs the operation of AUTOM, the Exchange's automated order routing, delivery, execution and reporting system for options. This proposed rule change would permit off-floor broker-dealers,<sup>9</sup> on a six-month pilot basis and subject to certain restrictions, to have electronic access to the specialist's limit order book<sup>10</sup> through AUTOM. The proposed rule change would also allow off-floor broker-dealer orders to be automatically executed on AUTO-X, the automatic execution feature of AUTOM, under certain conditions.

The proposal generally permits certain off-floor broker-dealer limit orders for up to 200 contracts, depending on the option, to be eligible for AUTOM order delivery on an issue-by-issue basis, subject to the approval of the Options Committee. The Exchange's Options Committee may increase the eligible order delivery size to an amount above 200 contracts on an issue-by-issue basis. Specifically, the proposed rule change provides that the following types of off-floor broker-dealer limit orders are

<sup>7</sup> See Securities Exchange Act Release NO. 45485 (February 27, 2002), 67 FR 10465.

<sup>8</sup> See letter to Nancy J. Sanow, Senior Special Counsel, Division, SEC, from Richard S. Rudolph, Counsel, Phlx, dated April 12, 2002 ("Amendment No. 5"). In Amendment No. 5, the Exchange proposes to add clarifying language to the proposed rule text providing that off-floor broker-dealer AUTO-X eligible limit orders may be eligible for the Exchange's NBBO Step-Up Feature on an issue-by-issue basis, subject to the approval of the Exchange's Options Committee.

<sup>9</sup> In Amendment No. 3, the Exchange clarified that the proposed rule change applies only to off-floor broker-dealer limit orders. The Exchange noted that on-floor broker-dealer limit orders (such as those entered via electronic interface with AUTOM by registered options traders ("ROTs") and specialists) would be governed by a separate proposed rule change that the Exchange has filed with the Commission and which is currently pending. See File No. SR-Phlx-2002-04. Thus, orders from specialists and ROTs would not be eligible for AUTOM or AUTO-X under this proposed rule change.

<sup>10</sup> The electronic "limit order book" is the Exchange's automated specialist limit order book, which accepts book eligible orders that are automatically routed by AUTOM 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.

eligible for AUTOM order delivery: day, GTC, simple cancel, simple cancel to reduce size (cancel leaves), cancel to change price, and cancel with replacement order.<sup>11</sup>

Proposed Commentary .05 establishes certain conditions and restrictions on the new use of AUTOM. First, the proposed rule states that off-floor broker-dealer orders must be represented on the Exchange floor by a floor member; such a floor member may be a floor broker or the specialist. Second, the proposal provides that off-floor broker-dealer orders delivered via AUTOM shall be for a minimum size of one (1) contract.

Third, proposed Commentary .05 states that the restrictions and prohibitions concerning electronically generated orders set forth in Exchange Rule 1080(i)<sup>12</sup> and off-floor market makers set forth in Exchange Rule 1080(j)<sup>13</sup> apply to orders entered for the account(s) of off-floor broker-dealers.

Fourth, proposed Commentary .05 provides that off-floor broker-dealer limit orders entered via AUTOM establishing a bid or offer may establish priority, and the specialist and crowd may match such a bid or offer and be at parity. Off-floor broker-dealer orders, however, are subject to the priority yielding provisions set forth in Exchange Rule 1014.<sup>14</sup> Fifth, the

<sup>11</sup> The Exchange stated that market makers from other markets could elect either to submit orders via AUTOM or via the proposed Plan for the Purpose of Creating and Operating an Intermarket Option Linkage ("Linkage").

<sup>12</sup> Exchange Rule 1080(i) prohibits members from entering, permitting, or facilitating the entry of orders into AUTOM if those orders are created and communicated electronically without manual input (*i.e.*, order entry by public customers or associated persons of members must involve manual input such as entering the terms of an order into an order-entry screen or manually selecting a displayed order against which an off-setting order should be sent). See Securities Exchange Act Release No. 43376 (September 28, 2000), 65 FR 59488 (October 5, 2000) (approving Exchange Rule 1080(i)) (SR-Phlx-00-79).

<sup>13</sup> Exchange Rule 1080(j) prohibits members from entering, or facilitating the entry into AUTOM, as principal or agent, limit orders in the same options series from off the floor of the Exchange, for the account or accounts of the same or related beneficial owners, in such a manner that the off-floor member or the beneficial owner(s) effectively is operating as a market maker by holding itself out as willing to buy and sell such options contract on a regular or continuous basis. See Securities Exchange Act Release No. 43939 (February 7, 2001) (approving Exchange Rule 1080(j)) (SR-Phlx-01-05).

<sup>14</sup> Exchange Rule 1014(g) provides that orders on controlled accounts must yield priority to customer orders, but are not required to yield priority to other controlled accounts. Thus, under proposed Commentary .05(ii), if an off-floor broker-dealer limit order entered via AUTOM establishes priority, and a customer order is entered into the limit order book at the same price, the off-floor broker-dealer limit order would be required to yield priority to

proposal provides that off-floor broker-dealer limit orders that are eligible for execution via AUTO-X entered via AUTOM for the account(s) of the same beneficial owner may not be entered in options on the same underlying security more frequently than every 15 seconds.<sup>15</sup>

The proposed rule change requires specialists to accept off-floor broker-dealer day or GTC orders, and to allow them to be automatically executed via AUTO-X. Additionally, the proposal would allow the AUTO-X guarantee for off-floor broker-dealer limit orders to be for a different number of contracts, on an issue-by-issue basis, than the AUTO-X guarantee for public customer orders, subject to the approval of the Options Committee.

Finally, the Exchange proposes to permit off-floor broker-dealer orders that are eligible for AUTO-X to be eligible for the Exchange's National Best Bid or Offer ("NBBO") Step-Up Feature. The Exchange's Options Committee would approve options for the NBBO Step-Up Feature for off-floor broker-dealer orders on an issue-by-issue basis.<sup>16</sup>

### III. Discussion

After careful review, the Commission 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>17</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>18</sup> which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and

the customer order. Phlx Rule 1014(g)(i) provides that a "controlled account" includes any account controlled by or under common control with a broker-dealer. See Securities Exchange Act Release No. 45114 (November 28, 2001) 66 FR 63277 (December 5, 2001).

<sup>15</sup> See Exchange Rule 1080(c)(ii). The Exchange has clarified that, where a non-member off-floor broker-dealer enters an order through a member, the prohibition against entry of orders more frequently than 15 seconds ("unbundling prohibition") applies only to the member. Telephone conversation between Richard S. Rudolph, Counsel, Phlx, Kelly Riley, Senior Special Counsel, Division, Commission, Gordon Fuller, Counsel to the Assistant Director, Division, Commission, and Christopher Solgan, Law Clerk, Division, Commission, on April 10, 2002. The Commission notes that the Exchange may not take punitive action against a non-member off-floor broker-dealer in the event that a member violates the unbundling prohibition.

<sup>16</sup> See Amendment No. 5, *supra* note 8.

<sup>17</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>18</sup> 15 U.S.C. 78f(b)(5).

open market, and to protect investors and the public interest.

The Commission finds that the proposed rule change should allow the Exchange to improve the efficiency with which orders for the account(s) of off-floor broker-dealers are currently executed. Currently, off-floor broker-dealer orders only have access to the limit order book manually and are not eligible to receive automatic execution in AUTO-X. By providing off-floor broker-dealers with access to AUTOM and AUTO-X, the Exchange should enhance executions and provide a better audit trail for these orders. Specifically, off-floor broker-dealer orders that are AUTO-X eligible should receive faster executions. Further, orders residing in the limit order book would now be exposed to more contra-side interest from off-floor broker-dealers in a more timely and efficient fashion, which should enhance the execution of booked orders. In addition, by providing prompt execution for off-floor broker-dealer orders, the proposal may help attract off-floor broker-dealer orders to the Exchange, and thus help to improve the depth and liquidity of the Exchange's options market.

The Commission believes that it is reasonable for the Exchange to permit off-floor broker-dealer orders to interact with the electronic limit order book and be eligible for execution on AUTO-X, provided the relevant Phlx systems have sufficient capacity and retail customers are not adversely affected. In this regard, the Exchange has represented that its systems are capable of processing the potential increased order flow through AUTOM and AUTO-X.<sup>19</sup> The Commission expects that during the six-month pilot period, the Exchange will monitor, AUTOM, its electronic limit order book and AUTO-X in light of the addition of off-floor broker-dealer orders and will implement any necessary system enhancements to accommodate any increase in volume resulting from this proposal.

The Commission notes that the Exchange has specifically clarified that off-floor broker-dealer orders are subject to the priority-yielding provisions of Exchange Rule 1014(g)(1).<sup>20</sup> The

<sup>19</sup> Telephone conversation between Richard S. Rudolph, Counsel, Phlx, Kelly Riley, Senior Special Counsel, Division, Commission, Gordon Fuller, Counsel to the Assistant Director, Division, Commission, and Christopher Solgan, Law Clerk, Division, Commission, on April 10, 2002.

<sup>20</sup> The Exchange submitted a letter to the Division representing that the proposal is consistent with Section 11(a) of the Act and Rule 11a2-2(T) under the Act. See letter to Catherine McGuire, Chief Counsel, Division, Commission, from Richard S. Rudolph, Counsel, Phlx, dated April 15, 2002. In response to the Exchange's request, Commission

Commission believes that this requirement of the proposal should ensure that retail customers are not adversely affected, and should promote investor protection by retaining customers orders' priority on the book.

In addition, the Commission believes that allowing off-floor broker-dealer orders to be eligible for automatic execution may enhance competition among the options exchanges. Currently, the Pacific Exchange, Inc. ("PCX") permits broker-dealer orders to be executed on the PCX's automatic execution system, Auto-Ex.<sup>21</sup> The Commission believes that the enhanced competition could lead to better quotes and executions for investors.

Finally, the Commission finds good cause for accelerating approval of Amendment No. 5 to the proposed rule change prior to the thirtieth day after publication in the **Federal Register**. The Commission believes that accelerated approval will permit the Exchange to implement, and investors to benefit from, the proposed rule change without undue delay. Amendment No. 5 provides that off-floor broker-dealer AUTO-X eligible limit orders would be eligible for the Exchange's NBBO Step-Up Feature of AUTO-X, on an issue-by-issue basis subject to approval by the Exchange's Options Committee, provided that the order is for a "NBBO Step-Up Option" as described in Exchange Rule 1080(c)(i), and provided that the NBBO does not differ from the Exchange's best bid or offer by more than the step-up parameter. The Commission believes that Amendment No. 5, which permits the use of the NBBO Step-Up Feature for off-floor broker-dealers, should provide better prices for those orders that are eligible. For this reason, the Commission finds good cause exists, consistent with Sections 6(b)(5)<sup>22</sup> and 19(b)(2) of the Act,<sup>23</sup> to approve Amendment No. 5 to the proposed rule change on an accelerated basis.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 5, including whether Amendment No. 5 is consistent with the Act. Persons making written submissions should file

staff has provided interpretive guidance to the Exchange under Section 11(a) of the Act, 15 U.S.C. 78k(a). See letter from Paula R. Jenson, Deputy Chief Counsel, Division, Commission, to Richard S. Rudolph, Counsel, Phlx, dated April 15, 2002.

<sup>21</sup> See Securities Exchange Act Release No. 45032 (November 6, 2001), 66 FR 57145 (November 14, 2001).

<sup>22</sup> 15 U.S.C. 78f(b)(5).

<sup>23</sup> 15 U.S.C. 78s(b)(2).

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 Amendment that are filed with the Commission, and all written communications relating to the Amendment 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 Exchange. All submissions should refer to file number SR-Phlx-2001-40 and should be submitted by May 13, 2002.

#### V. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and rules and regulations thereunder.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>24</sup> that the proposed rule change (SR-Phlx-2001-40), as amended, is approved, on a six-month pilot basis, until October 15, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>25</sup>

**Margaret H. McFarland**

*Deputy Secretary.*

[FR Doc. 02-9780 Filed 4-19-02; 8:45 am]

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## DEPARTMENT OF TRANSPORTATION

### Coast Guard

[Docket No. OST-1996-1437]

#### Privacy Act of 1974: System of Records

**AGENCY:** Coast Guard, DOT.

**ACTION:** Notice to establish a system of records.

**SUMMARY:** DOT proposes to establish a new system of records under the Privacy Act of 1974 and exempt the system from certain provisions of the Act.

**EFFECTIVE DATE:** June 3, 2002. If no comments are received, the proposal will become effective on the above date. If comments are received, the comments will be considered and, where adopted,

the documents will be republished with changes.

**ADDRESSES:** To make sure your comments and related material are not entered more than once in the docket, please submit them by only one of the following means:

(1) By mail to the U.S. Department of Transportation, Docket Management Facility (OST-1996-1437), 400 7th Street, SW., Washington, DC 20590.

(2) By delivery to the NASSIF Building, 400 7th Street, SW., PL-401 Washington, DC room PL-401, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. The telephone number is 202-366-9317.

(3) By fax to the Docket Management Facility at 202-493-2251. Include the docket number OST-1996-1437.

(4) Electronically through the Website for the Docket Management System at <http://dms.dot.gov>. Include the docket number OST-1996-1437. The Docket Management Facility maintains the public docket for this rulemaking. Comments and material received from the public, as well as documents mentioned in this preamble as being available in the docket, will become part of this docket and will be available for inspection or copying at room PL-401 on the Plaza level of the NASSIF Building, 400 Seventh Street SW., Washington, DC between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. You may also find this docket on the Internet at <http://dms.dot.gov>.

**FOR FURTHER INFORMATION CONTACT:** If you have questions on this notice, call Mr. Gary Chappell, Marine Safety Data Administration, Coast Guard, telephone 202-267-1061 or by email at [gchappell@comdt.uscg.mil](mailto:gchappell@comdt.uscg.mil). If you have questions on viewing or submitting material to the docket, call Dorothy Beard, Chief, Dockets, Department of Transportation, telephone 202-366-9317.

**SUPPLEMENTARY INFORMATION:** The purpose of this notice is to propose the establishment of a system of records that maintains information regarding the operation, management, and decision-making functions of the Coast Guard as they pertain to marine safety, maritime security, maritime law enforcement, and marine environmental protection activities, to be known as the Marine Information for Safety and Law Enforcement system (MISLE). MISLE will replace, and thus retire, the Marine Safety Information System (MSIS). As of December 13, 2001, MSIS is no longer used to collect information; however, the information contained in MSIS will be retained for historical purposes in

accordance with the MSIS Privacy Act Notice (DOT/CG 588). MISLE is an information system that will support the information needs and business processes of Marine Safety and Operations activities within the USCG.

MISLE may contain information on vessel owners, operators, charterers, managers, agents, crewmembers, or passengers; facility owners, operators, managers, or employees; individuals who own, operate, or represent marine transportation companies, and other individuals who come into contact with the Coast Guard through its Maritime Law Enforcement, Investigation, Marine Safety, Maritime Security, and Marine Environmental Protection activities. Information collected may include involved party (individual, company, government agency or organization) name, involved party identification number (IPN), Social Security number, Drivers License number, Foreign ID number, Passport number, VISA number, Immigration and Naturalization Service (INS) number, Military ID number, USCG License number, Cedula number, Foreign Seaman's Booklet number, resident alien number, Merchant Mariners License number, Merchant Mariner Documentation number, or taxpayer identification number (TIN).

A description of the steps taken to safeguard records contained in this system is given under the "Safeguards" heading of the **Federal Register** system of records notice. The Routine Uses described in the system of records notice satisfy the compatibility requirement of subsection (a)(7) of the Privacy Act, as they all support the operation, management, and decision-making functions of the USCG as they pertain to Marine Safety, Maritime Security, Maritime Law Enforcement, and Marine Environmental Protection.

#### DOT/CG 679

##### SYSTEM NAME:

Marine Information for Safety and Law Enforcement (MISLE).

##### SECURITY CLASSIFICATION:

Unclassified, Sensitive.

##### SYSTEM LOCATION:

U.S. Coast Guard (USCG), Operations Systems Center, 600 Coast Guard Drive, Kearneysville, WV 25430-3000.

##### CATEGORIES OF INDIVIDUALS COVERED BY THE SYSTEM OF RECORDS:

Individuals with established relationship(s) and/or association(s) to vessels, facilities (including platforms, bridges, deep-water ports, marinas, terminals, and factories), and activities.

<sup>24</sup> 15 U.S.C. 78s(b)(2).

<sup>25</sup> 17 CFR 200.30-3(a)(12).