David M. Battan
Vice President and General Counsel

July 22, 2003

<u>VIA FEDERAL EXPRESS AND E-MAIL</u>

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Proposed Rule Change by the Philadelphia Stock Exchange to Delete the Prohibition Against the Delivery of Electronically Generated Orders Via AUTOM, File No. SR-PHLX-2003-37

Dear Mr. Katz:

The Interactive Brokers Group LLC ("IB Group")[1] respectfully submits these comments on the proposed rule change submitted by the Philadelphia Stock Exchange ("PHLX" or "Exchange") proposing to remove the prohibition against delivery of option orders to the exchange that have been generated and transmitted electronically. As set forth below, we commend the Exchange for proposing to remove this outdated rule, which hinders the public's access to the Exchange and serves only to protect those market participants who have not invested the proper time and capital to ensure that their trading

[1] The Interactive Brokers Group is a global group of companies that provide liquidity to the capital markets and that provide advanced trading tools and market access to brokerage customers. IB Group affiliate Timber Hill LLC is a specialist and market maker on all U.S. option exchanges. IB Group affiliate Interactive Brokers LLC is a member of all U.S. option exchanges and provides its brokerage customers with direct electronic trading access to those exchanges.

systems are sufficiently robust and advanced. We urge the Commission to approve the proposal.

Discussion

Exchange specialists and market makers are provided with a profitable, often exclusive franchise, in which they are granted certain rights to trade against orders coming to the Exchange in their option classes and in return are obligated to invest their energy and capital in making fast, accurate and liquid markets available to the public. Several years ago, in response to the advent of direct access electronic trading systems for customers, certain members urged the options exchanges to enact a number of rules intended to limit access to their markets and to protect specialists and market makers from public traders, who were said to have superior trading and option pricing technology. Thus, option exchanges enacted rules preventing orders from being sent on the same side of the market by the same customer in the same class within 15 seconds; rules disabling auto-ex systems in certain circumstances; and rules preventing orders from being created and transmitted without "manual intervention."

The rationale for these rules – that professional specialists and market makers needed artificial trading constraints to protect them from public customers and other broker-dealers -- was backward from the start and is now increasingly untenable. As noted above, specialists are given exclusive trading rights because they are in turn expected to invest their capital in creating high quality, state-of-the-art national markets. Rules that artificially hamper public traders and allow specialists to under-invest and defer upgrading their technology and operations are not consistent with a healthy market. Indeed, a minority of option market participants have caused serious problems in the national option market over the past several years by disseminating stale quotes, violating their firm quote obligations, and generally not investing sufficient time and money in upgrading their systems and preparing to participate in the intermarket linkage system. Protective rules that artificially enable these participants to continue to prosper even without sufficient investment in their operations are not helpful.

The rule that PHLX now wisely seeks to remove -- which prevents public customers from using computers to generate and transmit orders, and requires some level of ill-defined "manual intervention"– is particularly backward-looking and inconsistent with the policies of a strong national market system. As Congress and the Commission have recognized, deployment of computer technology has made the securities markets faster, far more efficient, and far cheaper for customers over recent years. Commissions and liquidity costs paid by the public have dropped sharply because of the increased efficiency provided by computerized trading and back office processes. Against this backdrop it is hard to imagine any continued justification for a rule that says that while market professionals are free to use whatever computer technology they wish – including autoquoting systems that do not require human intervention – public customers and other broker dealers must nonetheless forego cheaply and readily available technology and trade with one hand tied behind their backs (the hand not being used for manual intervention, presumably). Indeed it is hard to imagine in the year 2003 a rule in any industry (save perhaps a casino) that says that a customer cannot use a computer to manage his or her transactions.

In addition to being anachronistic, the rule requiring human intervention in public customer option trading is also difficult and expensive for exchanges to enforce. Policing public customers and non-market maker broker-dealers to ensure that they have at least a single keystroke in their order entry process is a gross waste of the time and resources of valuable exchange and member firm compliance staff. Further, the rule merely encourages traders to insert manual steps into their trading processes that are formalistic and serve only to increase the chance of customer error. This is not sound public policy.

On the other hand, removal of the rule will improve the quality of the PHLX market by allowing traders to access that market faster. Customers will be able to post competitive limit orders more quickly. Specialists who persistently post stale or erroneous quotes will also more quickly suffer the consequences and will be forced, in time, to upgrade their operations and update their prices faster. This will, in turn, improve the quality of the National Best Bid and Offer and enhance the utility of the intermarket linkage system for options, which has been hampered by late and incorrect quotes posted by a handful of participants.

The options exchanges have started to repeal some of the rules that hamper free and open competition and artificially slow-down and impede trading (for example, ISE's elimination of its 15 second "speed-bump" rule). We urge the Commission to encourage the exchanges in these efforts and quickly to approve any exchange efforts – like this one – to modernize their trading rules.

Sincerely,

David M. Battan

cc: Chairman William H. Donaldson
Commissioner Cynthia A. Glassman
Commissioner Harvey J. Goldschmid
Commissioner Paul S. Atkins
Commissioner Roel C. Campos
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