

Dated: March 19, 2002.

**Jonathan G. Katz,**

*Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45566; File No. SR-Amex-2001-68]

### Self-Regulatory Organizations; Order Approving a Proposed Rule Change by the American Stock Exchange LLC to Adopt Sanctioning Guidelines for Violations of the Exchange's Order Handling Rules

March 15, 2002.

#### I. Introduction

On September 4, 2001, the American Stock Exchange LLC ("Amex" 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 adopt sanctioning guidelines for violations of its options order handling rules.<sup>3</sup> The proposed rule change was published for comment in the **Federal Register** on February 13, 2002.<sup>4</sup> No comments were received on the proposed rule change. This order approves the proposed rule change.

#### II. Description of the Proposal

The Exchange proposes to adopt sanctioning guidelines for violations of its options rules related to firm quotes (Exchange Rule 958A), limit order display (Exchange Rule 958A),<sup>5</sup> priority, parity, and precedence (Exchange Rules 111, 126, 155, 950, and 958),<sup>6</sup> and trade

reporting (Exchange Rule 992). The Exchange also proposes to adopt sanction guidelines for its rule regarding anti-competitive behavior and harassment (Exchange Rule 16).

The Exchange has developed the proposed sanction guidelines for use by the various bodies adjudicating disciplinary matters in determining appropriate sanctions.<sup>7</sup> These bodies include Disciplinary Panels, the Amex Adjudicatory Council and the Amex Board of Governors ("Adjudicators"). The proposed guidelines provide both a range of fines as well as non-monetary sanctions that could be assessed against offending members. Fine amounts would differ depending on the number of disciplinary actions that have been brought by the Exchange against the particular member or member organization.<sup>8</sup> The proposed guidelines would also allow for non-monetary sanctions such as suspension, expulsion, or other sanctions in egregious cases. The guidelines may also be used by parties to a disciplinary action in entering into a stipulation of facts and consent to penalty.

The proposed sanction guidelines contain an introductory section that explains the overall purpose of the guidelines and sets forth general principles that apply to all sanctions determinations. The proposed introductory section also includes principal considerations for determining sanctions that may be considered as aggravating or mitigating factors. The proposed sanctioning guidelines contain individual guidelines that provide specific monetary and non-monetary sanctions generally applicable to the violations at issue and list additional principal considerations for the specific violations.

#### III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the

members with respect to orders and, therefore, embody the concept of best execution.

<sup>7</sup> The Exchange submitted to the Commission a letter, for which it requested confidential treatment, proposing how its regulatory staff would aggregate violations of the order handling rules, where the violations are identified through the Exchange's automated surveillance system. See letter from Richard T. Chase, Executive Vice President, Amex, to John McCarthy, Associate Director, Office of Compliance, Inspections and Examinations, Commission, dated December 24, 2001.

<sup>8</sup> When determining whether an action is the first disciplinary action, the Adjudicators would consider disciplinary actions with respect to violative conduct that occurred within the two years prior to the misconduct at issue. Recent acts of similar misconduct may be considered to be aggravating factors. For purposes of the proposed rule change, this two year look back provision would apply on a rolling basis.

Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>9</sup> In particular, the Commission believes that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>10</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 open market, and to protect investors and the public interest. The Commission also finds that the proposed rule change is consistent with Section 6(b)(6) of the Act,<sup>11</sup> which requires that the rules of an exchange provide that its members be appropriately disciplined for violations of exchange rules, the Act, and rules and regulations thereunder, by expulsion, suspension, limitation of activities, functions, and operations, fine, censure, being suspended or barred from being associated with a member, or any other fitting sanction.

Moreover, the Commission notes that the Exchange submitted a letter, for which it requested confidential treatment, proposing how its regulatory staff would aggregate violations of the order handling rules, where such violations are identified through the Exchange's automated surveillance systems.<sup>12</sup> The Commission believes that the compliance thresholds proposed in this letter provide a reasonable first step and should assist the Exchange in disciplining its members for violations of the Exchange's order handling rules. The Commission expects, however, that as compliance rates improve, the Exchange will adjust the compliance thresholds accordingly. Consequently, the Commission's approval of the proposed rule change is contingent on the Exchange providing notice to the Commission's Office of Compliance Inspections and Examinations of any future changes to this letter, and to any other sanctioning guidelines not codified in the Exchange's rules.

At this time, the Commission believes the proposed sanctioning guidelines are reasonably designed to effectively enforce compliance with the options order handling rules. Nevertheless, the Commission expects the Exchange to

<sup>9</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>10</sup> 15 U.S.C. 78f(b)(5).

<sup>11</sup> 15 U.S.C. 78f(b)(6).

<sup>12</sup> See *supra* note 7.

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

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

<sup>3</sup> The Exchange filed this proposed rule change pursuant to the provisions of Section IV.B.i of the Commission's September 11, 2000 Order Instituting Public Administrative Proceedings Pursuant to Section 19(b)(1) of the Act, which required the Exchange to adopt rules establishing, or modifying existing, sanctioning guidelines such that they are reasonably designed to effectively enforce compliance with options order handling rules. See Securities Exchange Act Release No. 43268 (September 11, 2000), Administrative Proceeding File No. 3-10282 ("Order").

<sup>4</sup> See Securities Exchange Act Release No. 45412 (February 7, 2002), 67 FR 6777.

<sup>5</sup> The Exchange has an option limit order display rule filing pending with the Commission. See SR-Amex-00-27.

<sup>6</sup> According to the Exchange, it does not have an explicit definition of its members' obligation of "best execution" owed to its customer. The Exchange states that its rules regarding firm quotes, limit order display, priority, parity and precedence, however, collectively define the obligations of

continue to evaluate the adequacy of the proposed sanctioning guidelines to determine whether they do, in fact, effectively enforce compliance with the options order handling rules.<sup>13</sup>

#### IV. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change 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>14</sup> that the proposed rule change (SR-Amex-2001-68) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45576; File No. SR-Amex-2001-76]

#### Self-Regulatory Organizations; Order Granting Partial Accelerated Approval of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto and Notice of Filing and Order Granting Partial Accelerated Approval of Amendment No. 3 Thereto by the American Stock Exchange LLC Relating to the Obligations of Specialists and Registered Options Traders

March 15, 2002.

#### I. Introduction

On September 12, 2001, the American Stock Exchange LLC ("Amex" or "Exchange") submitted to the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change relating to collective actions of specialists and registered options traders.<sup>3</sup> The Amex filed Amendment

Nos. 1 and 2 to the proposed rule change on December 17, 2001<sup>4</sup> and January 18, 2002,<sup>5</sup> respectively. The **Federal Register** published the proposed rule change and Amendment Nos. 1 and 2 for comment on February 14, 2002.<sup>6</sup> The Exchange filed Amendment No. 3 to the proposed rule change on March 13, 2002.<sup>7</sup> The Commission received no comments on the proposed rule change. The Commission is publishing notice of Amendment No. 3 to solicit comments from interested persons. The Commission is also granting accelerated approval to all portions of the proposed rule change, as amended by Amendment Nos. 1, 2, and 3, except for the provision of proposed Commentary .02(b) to Amex Rule 950 that states that "[w]ith respect to orders sent through the Exchange's order routing systems it is presumed that the member has requested a collective response."

#### II. Description of Proposal

The Exchange proposes to amend Exchange Rules 950, 958, and 958A to codify its interpretation that unless otherwise provided for in Exchange rules, it is a violation of just and equitable principles of trade for specialists and registered options traders ("traders") to determine by agreement the spreads or prices at which they will trade any option class, or the allocation of orders in any option class. The Exchange believes that there are, however, certain specific circumstances where, in order to make fair and orderly markets that are competitive with other exchanges and

rules to make express any practice or procedure "whereby market makers trading any particular option class determine by agreement the spreads or option prices at which they will trade any option class . . . ." See Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions. Securities Exchange Act Release No. 43268 (September 11, 2000).

<sup>4</sup> The Amex submitted a new Form 19b-4, which replaces and supersedes the original filing in its entirety ("Amendment No. 1").

<sup>5</sup> Letter from Claire P. McGrath, Vice President and Deputy General Counsel, Amex, to Elizabeth King, Associate Director, Division of Market Regulation ("Division"), Commission, dated January 16, 2002 ("Amendment No. 2"). Amendment No. 2 amends proposed Amex Rules 950 and 958 to clarify that "large order" means orders larger than the size communicated or disseminated pursuant to Exchange Rule 958 or larger than the Exchange's auto-ex eligible size. Amendment No. 2 also makes a technical correction to proposed Amex Rule 958(h)(iii).

<sup>6</sup> Securities Exchange Act Release No. 45413 (February 7, 2002), 67 FR 6953.

<sup>7</sup> Letter from Claire P. McGrath, Vice President and Deputy General Counsel, Amex, to Elizabeth King, Associate Director, Division, Commission, dated March 8, 2002 ("Amendment No. 3").

responsive to the needs and expectations of investors, some communication among the specialist and traders may be necessary and appropriate. According to the Exchange, these circumstances arise: (1) in connection with the specialist's establishment of parameters used by the Exchange's automated quotation updating system (known as "X-TOPS") to automatically generate options quotations in response to changes in the market for the underlying security or index; (2) in responding to customer requests for markets in size, such that the collective efforts of the specialist and traders are necessary in order to be able to fill any resulting order to buy or sell options; and (3) whenever the specialist and traders, in order to fulfill their obligations pursuant to Rule 11Ac1-1 under the Act and Amex Rule 958A, and to be competitive with other exchanges, collectively agree as to the best bid, best offer, and aggregate quotation size. The following is a description of the nature and extent of the joint action among the specialist and traders that is permitted under each of these circumstances.

#### X-TOPS Parameters

Proposed Commentary .02 to Exchange Rule 950(n) and proposed paragraph (h) to Exchange Rule 958 would (i) require the specialist to disclose to all registered option traders in an option class the variables of the formula used to generate automatically updated market quotations for each option class and/or series, and (ii) permit the specialist to receive input from the registered options traders on any one or all of these variables provided, however, that it is within the specialist's sole discretion to make the final independent decision in determining the variables to be used in the X-TOPS formula. Registered options traders would not be required to provide input into these decisions. Those specialists using an Exchange-approved proprietary system to calculate and generate quotes may be exempt by the Exchange from having to disclose proprietary information concerning the variables (but not the variables themselves) used by their systems.

#### Joint Responses to Requests for Markets

Proposed Commentary .02 to Exchange Rule 950(n) and proposed new paragraph (h) to Exchange Rule 958 would expressly permit a collective response to a request for a market to buy or sell option contracts in sizes larger than the greater of the Auto-Ex eligible size or the size communicated or disseminated pursuant to Exchange

<sup>13</sup> The Commission's examination staff will also monitor the application of these guidelines to determine whether they do, in fact, improve member compliance with the options order handling rules.

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

<sup>15</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> The Amex submitted the proposed rule change pursuant to subparagraph IV.B.j of the Commission's September 11, 2000 Order, which requires in part that certain options exchanges, including the Amex, adopt new, or amend existing,