

February 13, 2002.⁴ No comments were received on the proposed rule change. This order approves the proposed rule change.

II. Description of the Proposal

Currently, violations of the Exchange's firm quote, limit order display, and priority rules are treated as formal disciplinary actions and outside the scope of the Exchange's Minor Rule Plan ("MRP").⁵ Violations of trade reporting and best execution obligations, however, are generally handled pursuant to the Exchange's MRP. While the MRP provides general guidance with respect to fine levels to be imposed for each distinct violation, nothing in the MRP prohibits the Exchange from removing a single violation of these obligations from the MRP and enforcing it as a formal disciplinary matter. The Exchange may also initiate a formal disciplinary action if it deems that a member or member organization's conduct amounts to a pattern or practice with respect to violations of the rules covered by its MRP or if its conduct in even a single instance is particularly egregious.

The Exchange proposes to establish specific fine levels for disciplinary actions initiated as a result of violations of the Exchange's rules relating to firm quote (Rule 6.86), limit order display (Rule 6.55), obligations of market makers, priority (Rule 6.75), best execution (Rule 6.46), and trade reporting (Rule 6.69). The proposed sanctioning guidelines would be used by various Exchange bodies that adjudicate disciplinary actions, including the Ethics and Business Conduct Committee, the PCX Board of Governors, the PCX Surveillance and Enforcement Departments, for in-house adjudications (collectively, "Adjudicatory Bodies"), in determining appropriate remedial sanctions. The proposal lists general principles that would be considered by the Adjudicatory Bodies in connection with the imposition of sanctions in all cases.⁶ 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.⁷ The proposed guidelines would also allow for non-monetary sanctions such as suspension, expulsion, or other sanctions in egregious cases.

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.⁸ In particular, the Commission believes that the proposed rule change is consistent with Section 6(b)(5) of the Act,⁹ 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,¹⁰ 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 systems¹¹. 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 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.¹²

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,¹³ that the proposed rule change (SR-PCX-2001-23) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁴

Margaret H. McFarland,
Deputy Secretary.

[FR Doc. 02-6894 Filed 3-21-02; 8:45 am]

BILLING CODE 8010-01-P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45578; File No. SR-PCX-2001-50]

Self-Regulatory Organizations; Order Approving Proposed Rule Change by the Pacific Exchange, Inc. Relating to Rules on Collective Actions of Market Makers

March 15, 2002.

I. Introduction

On December 13, 2001, the Pacific Exchange, Inc. ("PCX" or "Exchange")

¹² 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.

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ 17 CFR 200.30-3(a)(12).

⁴ See Securities Exchange Act Release No. 45416 (February 7, 2002), 67 FR 6777.

⁵ See PCX Rule 10.13.

⁶ 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 Hassan A. Abedi, Manager, Enforcement, PCX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated December 21, 2001.

⁷ When determining whether an action is the first disciplinary action, the Adjudicatory Body 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. Telephone conversation between Hassan A. Abedi, Manager, Enforcement, PCX, and Sonia Patton, Special Counsel, Division, Commission, on February 6, 2002.

⁸ 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).

⁹ 15 U.S.C. 78f(b)(5).

¹⁰ 15 U.S.C. 78f(b)(6).

¹¹ See supra note 6.

submitted to the Securities and Exchange Commission ("Commission" or "SEC"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change relating to collective actions of market makers. The **Federal Register** published the proposed rule change for comment on February 12, 2002.³ The Commission received no comments on the proposed rule change. This order approves the proposed rule change.

II. Description of Proposal

The Exchange has submitted the proposed rule change pursuant to subparagraph IV.B.j of the Commission's September 11, 2000 Order,⁴ which requires in part that certain options exchanges, including the PCX, adopt new, or amend existing, 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. The Exchange is proposing to amend PCX Rule 6.37 ("Obligation of Market Makers") by adding a new subsection (e) to be entitled, "Prohibited Practices and Procedures." Proposed subsection (e)(1) would state that any practice or procedure whereby market makers trading any particular option issue determine by agreement the spreads or option prices at which they will trade that issue is prohibited, subject to three exceptions set forth in proposed PCX Rule 6.37(f), which are described below.

Subsection (1) to proposed PCX Rule 6.37(f) would permit the Lead Market Maker ("LMM") to receive input from the members of the trading crowd on the variables of the formula the LMM uses to generate automatically updated market quotations in each option issue, but the members of the crowd would not be required to provide feedback. In addition, it would be within the LMM's sole discretion to make the final independent decision regarding the variables to be used in operating the automated quotation system. Finally, subsection (1) would state that LMMs using Exchange-approved proprietary automated quotation updating systems are not required to disclose proprietary

information concerning the variables used by those systems.

Subsection (2) of proposed PCX Rule 6.37(f) would state that the obligation of market makers to make competitive markets would not preclude the LMM and members of the trading crowd from making a collective response to a request for a market, provided the member representing the order requests such a response in order to fill a large order. A large order would be defined as an order for a number of contracts that is greater than the eligible order size for automatic execution pursuant to PCX Rule 6.87.

Subsection (3) of proposed PCX Rule 6.37(f) would state that in conjunction with their obligations as a responsible broker or dealer pursuant to PCX Rule 6.86 and SEC Rule 11Ac1-1,⁵ the LMM and market makers in the trading crowd may collectively agree to the best bid, best offer and aggregate quotation size required to be communicated to the Exchange pursuant to PCX Rule 6.86(c).

The Exchange is also proposing a similar change to PCX Rule 6.82 ("Obligations of Lead Market Makers") by adding new subsection (c)(8), which would provide that LMMs are responsible for establishing the variables in the formula used to generate automatically updated quotations in each option issue or series. It would also permit the LMM to disclose the autoquote variables to the members of the trading crowd.

III. Discussion

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.⁶ Specifically, the Commission believes that the proposed rule change is consistent with the Section 6(b)(8)⁷ requirement that the rules of an exchange not impose any burden on competition not necessary or appropriate in furtherance of the Act.

The Commission believes that the proposed rule change should deter collective action on the part of Exchange members by clearly establishing in the Exchange's rules that options market makers are prohibited from determining by agreement the spreads or option prices at which they will trade an issue, subject to certain specified exceptions that the Commission herein approves.⁸

For instance, the proposal would permit LMMs to receive input from members of the crowd in setting the parameters of the formula used to automatically update options quotations. At this time, the Commission believes it is reasonable for the Exchange's rules to permit members of the crowd to be given a voice in setting autoquote parameters because, pursuant to the Exchange's rules, they will be obligated to execute orders at the resultant quote.

In addition, the proposed rule change would permit the LMM and members of the crowd to make a collective response to a request to fill a large order, provided that a collective response is requested. The Commission believes that this exception recognizes the desire of the marketplace to provide a single price to a request to fill a large order that a single member would not be able to fill. The Commission believes that any anticompetitive effect of this exception is limited by requiring that there be a member's specific request for a single price and that the order be sufficiently large. In addition, the Commission notes that notwithstanding this exception, a single crowd participant may voice a bid or offer independently from, and differently from, the LMM and other members of a trading crowd.

Finally, the Commission finds that the proposed rule change is designed to effectively limit the circumstances in which collective action is permissible.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁹ that the proposed rule change (SR-PCX-2001-50) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁰

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 02-6903 Filed 3-21-02; 8:45 am]

BILLING CODE 8010-01-P

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 45392 (February 5, 2002), 67 FR 6567.

⁴ 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).

⁵ 17 CFR 240.11Ac1-1.

⁶ In approving the proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁷ 15 U.S.C. 78f(b)(8).

⁸ The Commission expects the Exchange to monitor the collective actions that are undertaken

pursuant to the rule change approved herein for any undesirable or inappropriate anticompetitive effects. The Commission's examination staff will monitor the Exchange's efforts in this regard.

⁹ 15 U.S.C. 78s(b)(2).

¹⁰ 17 CFR 200.30-3(a)(12).