

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

<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,

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

Rule 958A,<sup>8</sup> provided the member requested the collective response.

In addition, the proposed rule change would permit the specialist to agree to transact the full size of the options order at a specific price unilaterally determined by the specialist and subsequently allocate portions of the order to registered options traders that wish to participate in the trade.<sup>9</sup> If or when a trade is executed under such circumstances, the contracts would be allocated in accordance with the Exchange's specialist and registered options traders participation policy.<sup>10</sup>

Finally, the Exchange proposes that with respect to orders sent through the Exchange's order routing systems that are larger than the size disseminated pursuant to Exchange Rule 958, it would be presumed that the member has requested a collective response.<sup>11</sup>

#### *Firm Quote Guarantees*

Currently, Amex Rule 958A obligates specialists and traders to be firm for (i) customer orders up to the quotation size being disseminated, and (ii) broker-dealer orders, up to the size established and periodically published by the Exchange. Rule 11Ac1-1 under the Act anticipates that exchanges will disseminate one automatically generated quote for a trading crowd, which necessitates collective action on behalf of the specialist and traders to communicate size to the Exchange. If or when a trade is executed, the contracts will be allocated in accordance with the Exchange's specialist and registered options traders participation policy.

### III. Discussion

The Commission finds that the proposed rule change, except for the portion that states that it is presumed for orders sent through the Exchange's order routing systems that the member has requested a collective response, is

<sup>8</sup> *Id.* Amendment No. 3 amends proposed Amex Rules 950 and 958 to clarify that "large order" means orders larger than the greater of the size communicated or disseminated pursuant to Exchange Rule 958 or larger than the Exchange's auto-ex eligible size.

<sup>9</sup> See Amendment No. 3, *supra* note 7. Amex No. 3 codifies in proposed Amex Rules 950 and 958 that the specialist may unilaterally give a single bid (offer) in response to a request for a market and subsequently discuss with the registered options traders whether they wish to participate in the contracts executed in accordance with that bid (offer).

<sup>10</sup> See Securities Exchange Act Release No. 42964 (June 20, 2000) 65 FR 39972 (June 28, 2000) (File No. SR-Amex-00-30) which proposes to codify current practices regarding the participation in option trades executed on the Exchange by registered options traders and specialists.

<sup>11</sup> As noted in Section III of this order, the Commission is not approving this provision at this time.

consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>12</sup> Specifically, the Commission believes that the proposed rule change, except for the portion that states that it is presumed for orders sent through the Exchange's order routing systems that the member has requested a collective response, is consistent with the Section 6(b)(8)<sup>13</sup> requirement that the rules of an exchange not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

The Commission believes that the portion of the proposed rule change approved herein 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.<sup>14</sup> For instance, the proposal would permit specialists 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 the 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 specialist and registered options traders to make a collective response to a member's specific 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 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

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

<sup>13</sup> 15 U.S.C. 78f(b)(8).

<sup>14</sup> 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.

differently from, the specialist and other members of a trading crowd.

At this time, the Commission is not approving the provision of proposed Commentary .02(b) to Amex Rule 950, that states that it is presumed that the member has requested a collective response for orders sent through the Exchange's order routing systems, because this proposed provision warrants further consideration.

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

The Commission finds good cause for accelerating approval of the proposed rule change and Amendment Nos. 1, 2, and 3 thereto prior to the thirtieth day after publication in the **Federal Register**. The Commission notes that the proposed rule change, as amended by Amendment Nos. 1 and 2, was published for the full comment period and the Commission is accelerating approval of the filing on the twenty-ninth day after publication of the proposed rule change, and Amendment Nos. 1 and 2, 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. The Commission notes that the Amendment No. 3 to the proposal clarifies the proposed rules in response to issues raised by Commission staff. Accordingly, the Commission finds that good cause exists, consistent with Sections 6(b)(8) of the Act,<sup>15</sup> and 19(b)(2) of the Act<sup>16</sup> to grant partial accelerated approval of the proposed rule change and Amendment Nos. 1, 2, and 3 thereto.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 3, including whether the Amendment No. 3 is consistent with the Act. Persons making written submissions should file 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 proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the

<sup>15</sup> 15 U.S.C. 78f(b)(8).

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

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 Amex. All submissions should refer to File No. SR-Amex-2001-76 and should be submitted by April 12, 2002.

## V. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>17</sup> that the proposed rule change (SR-Amex-2001-76), as amended, except for the portion that states that it is presumed for orders sent through the Exchange's order routing systems that the member has requested a collective response, is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>18</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 02-6901 Filed 3-21-02; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45571; File No. SR-CBOE-2001-71]

### Self-Regulatory Organizations; Order Granting Accelerated Approval of Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 Thereto by the Chicago Board Options Exchange, Inc. To Incorporate Certain Principal Considerations in Determining Sanctions and To Incorporate in the Exchange's Minor Rule Violation Plan Violations of the Exchange's Order Handling Rules

March 15, 2002.

## I. Introduction

On December 26, 2001, the Chicago Board Options Exchange, Inc. ("CBOE" 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 and to incorporate in its Minor Rule Violation Plan violations of the Exchange's order

handling rules.<sup>3</sup> The proposed rule change was published for comment in the **Federal Register** on February 14, 2002.<sup>4</sup> On March 7, 2002, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>5</sup> No comments were received on the proposed rule change. This order granted accelerated approval to the proposed rule change and issues notice of filing and approves Amendment No. 1 on an accelerated basis.

## II. Description of the Proposal

The Exchange proposes to amend CBOE Rule 17.11 (Judgment and Sanction) to incorporate certain Principal Considerations in Determining Sanctions ("Principal Considerations") to be applied by the Exchange's BCC in determining appropriate remedial sanctions through the resolution of disciplinary matters through offers of settlement or after formal disciplinary hearings. In addition, the Exchange proposes to amend CBOE Rule 17.50 (Imposition of Fines for Minor Rule Violations) to incorporate in its MRP violations of the Exchange's order handling rules, including violations of firm quote requirements pursuant to Exchange Rule 8.51; failure to promptly book and display limit orders that would improve the disseminated quote pursuant to Exchange Rules 7.7 and 8.85(b); failure to honor the priority of marketable customer orders maintained in the Customer Limit Order Book pursuant to Exchange Rule 6.45; and failure to use due diligence in order execution pursuant to Exchange Rules 6.73 and 8.85(b). The proposed rule change would provide both a range of fines as well as non-monetary sanctions

<sup>3</sup> The Exchange filed this proposed rule change pursuant to the provisions of Section IV.B.1 of the Commission's September 11, 2000 Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(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 (the "Order").

<sup>4</sup> See Securities Exchange Act Release No. 45427 (February 8, 2002), 67 FR 6958.

<sup>5</sup> See letter from Edward Joyce, President and Chief Operating Officer, CBOE, to Deborah Lassman Flynn, Assistant Director, Division of Market Regulation, Commission, dated March 1, 2002 ("Amendment No. 1"). In Amendment No. 1, the Exchange clarified that the Exchange would aggregate individual violations of options order handling rules and treat such violation as a single offense only where such aggregation is based on a comprehensive automated surveillance program. In addition, the Exchange clarified that a sixth and subsequent violation of the options order handling rules would be referred to the Business Conduct Committee ("BCC") and not treated under the Exchange's Minor Rule Plan ("MRP").

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>6</sup> The proposed guidelines would also allow for non-monetary sanctions such as suspension, expulsion, or other sanctions in egregious cases. Finally, the proposed rule change would also permit any member who is issued a summary fine notice to have the opportunity to submit one written offer of settlement to the BCC.

## 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.<sup>7</sup> In particular, the Commission believes that the proposed rule change is consistent with section 6(b)(5) of the Act,<sup>8</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>9</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

<sup>6</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 Mary L. Bender, Senior Vice President and Chief Regulatory Officer, CBOE, to John McCarthy, Associate Director, Office of Compliance, Inspections and Examinations, Commission, dated December 21, 2001.

<sup>7</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>8</sup> 15 U.S.C. 78f(b)(5).

<sup>9</sup> 15 U.S.C. 78f(b)(6).

<sup>17</sup> 15 U.S.C. 78s(b)(2).

<sup>18</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.