SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–45575; File No. SR–Phlx–2001–25]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment Nos. 1 and 2 Thereto by the Philadelphia Stock Exchange, Inc. Relating to the Exchange's Auto-Quote System

March 15, 2002.

I. Introduction

On March 5, 2001, the Philadelphia Stock Exchange, Inc. (''Phlx'' or ''Exchange'') submitted to the Securities and Exchange Commission (''Commission''), 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 the Exchange's Auto-Quote System. The Phlx submitted amendments to the proposed rule change on August 29, 2001 [3] and October 31, 2001.[4] The **Federal Register** published the proposed rule change and Amendment Nos. 1 and 2 for comment on November 23, 2001.[5] The Commission received no comments on the proposed rule change. This order approves the proposed rule change, as amended.

II. Description of Proposal

The Phlx proposes to amend Commentary .01 to Exchange Rule 1080 to add language providing an enhanced description of Auto-Quote, the Exchange's electronic options pricing system and to permit the specialist to consult with the trading crowd in setting Auto-Quote parameters.

On September 11, 2000, the Commission issued an order [6] that requires in part that the Phlx adopt new, or amend existing, rules to include any practice or procedure, not currently authorized by rule, whereby market makers determine by agreement the spreads or option prices at which they will trade any option class.[7] The Exchange submitted the proposed rule change pursuant to this undertaking.

The proposed rule change would incorporate a more thorough description of Auto-Quote into Exchange rules. First, it would describe its various pricing models, inputs, and parameters. Second, it would provide that specialists may establish a specialized proprietary connection (''specialized quote feed'') that by-passes the Auto-Quote system. Finally, it would provide that while the specialist selects the pricing model and inputs for Auto-Quote, he or she may (but is not required to and may, for proprietary business reasons, determine not to) consult with the trading crowd on the pricing model and the inputs to be used. The proposed rule change also provides that if the specialist consults with one member of the crowd, all members of the crowd present must be given the opportunity to provide input.[8] However, members of the trading crowd would not be required to provide input to the specialist in setting Auto-Quote parameters.[9]

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.[10] Specifically, the Commission believes that the proposed rule change is consistent with the section 6(b)(8) [11] 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 proposed rule change should deter collective action, except as authorized by the Exchange's rules, by clearly establishing in the Exchange's rules the responsibilities of, and conduct permitted by, Exchange members in setting Auto-Quote parameters.[12] 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. 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. 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,[13] that the proposed rule change (SR–Phlx–2001–25) is approved, as amended.

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

Margaret H. McFarland,

Deputy Secretary.

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[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Letter from Richard S. Rudolph, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division of Market Regulation (''Division''), Commission, dated August 28, 2001 (''Amendment No. 1'').

[4] Letter from Richard S. Rudolph, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated October 30, 2001 (''Amendment No. 2'').

[5] Securities Exchange Act Release No. 45060 (November 15, 2001), 66 FR 58771.

[6] *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) (''Order'').

[7] *See* Section IV.B.j. of the Order.

[8] *See* Amendment No. 1, *supra* note 3. Among other things, Amendment No. 1: (i) states the reasons why a specialist would wish to consult with the trading crowd about specific Auto-Quote parameters; (ii) clarifies that if a specialist decides to consult with one member of the trading crowd about the Auto-Quote parameters, all members of the crowd that are present at the time must be given the opportunity to consult; and (iii) revises proposed Commentary .01(b)(ii) to Phlx Rule 1080 to state that the specialist may determine which model to select per option, not per series, as previously stated.

[9] *See* Amendment No. 2, *supra* note 4. Amendment No. 2 revises the text of proposed Commentary .01(b)(ii) to Phlx Rule 1080 to clarify that where the specialist determines to consult with and/or agree with the trading crowd with respect to selecting the Auto Quote System model or setting the parameters, members of the trading crowd are not required to provide input to the specialist about these decisions.

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

[11] 15 U.S.C. 78f(b)(8).

[12] 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.

[13] 15 U.S.C. 78s(b)(2).

[14] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–45570; File No. SR–Phlx–2001–114]

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 Philadelphia Stock Exchange, Inc. Relating to Aggregation of Individual Violations of Exchange Order Handling Rules and Option Floor Procedure Advices

March 15, 2002.

I. Introduction

On December 18, 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''),[1] and Rule 19b–4 thereunder,[2] a proposed rule change to amend Exchange Rule 960.2(f) and Exchange Rule 970 to permit the Exchange to aggregate, or ''batch,'' individual violations of Exchange order handling rules and Option Floor Procedure Advices (''OFPAs'') and consider such ''batched'' violations as a single offense.[3] The proposed rule change was published for comment in the **Federal Register** on February 14, 2002.[4] On March 8, 2002, the Exchange filed Amendment No. 1 to the proposed rule change.[5] No comments were received on the proposed rule change. This order approves the proposed rule change on an accelerated basis and issues notice of filing and grants accelerated approval to Amendment No. 1.

II. Description of the Proposal

The proposed rule change would clarify that the Exchange may consider multiple numbers of violations of order handling rules and OFPAs[6] as one single offense, where automated surveillance is available,[7] for purposes of initiating disciplinary action under Exchange rules, or imposing fines pursuant to fine schedules set forth in the relevant OFPAs under the Exchange's Minor Rule Plan. Such aggregation of order handling violations would enable the Exchange's Market Surveillance Department to identify, through exception reporting,[8] members and member organizations that fail to meet acceptable compliance thresholds for such rules and OFPAs, and to determine whether to impose fines pursuant to the Exchange's Minor Rule Plan or refer the matter to the Business Conduct Committee (''BCC'') for consideration of formal disciplinary action.[9] In addition, as an alternative to aggregation, the Exchange may refer violations to the BCC for possible disciplinary action when the Exchange determines that there exists a pattern or practice of violative conduct without exceptional circumstances or when any single instance of violative conduct without exceptional circumstances is deemed to be egregious.[10]

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.[11] In particular, the Commission believes that the proposed rule change is consistent with Section 6(b)(5) of the Act,[12] 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,[13] 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.[14] 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.[15]

Furthermore, the Commission finds good cause for accelerating approval of the proposed rule change and Amendment No. 1 thereto prior to the thirtieth day after publication in the **Federal Register**. The Commission notes that the proposed rule change was noticed for the full comment period and

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] The Exchange filed this proposed rule change in accordance with the provisions of Section IV.B.i 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 (''Order'').

[4] *See* Securities Exchange Act Release No. 45421 (February 7, 2002), 67 FR 6961.

[5] *See* letter from Richard S. Rudolph, Director and Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division of Market Regulation (''Division''), Commission, dated March 7, 2002 (''Amendment No. 1''). In Amendment No. 1, the Exchange clarified that ''batching'' of violations can occur only where the Exchange uses automated surveillance to detect violations.

[6] Specifically, the Exchange proposes, pursuant to its Numerical Criteria for Bringing Cases for Violations of Phlx Order Handling Rules, to ''batch'' violations of Exchange Rule 1051 (concerning the requirement that a member or member organization initiating an options transaction must report or ensure that the transaction is reported within 90 seconds of execution); Exchange Rule 1082 (concerning the requirement that quotes be firm for both price and size, and the requirement that marketable orders received in a size greater than the disseminated size be executed in their entirety or up to the disseminated size within 30 seconds); OFPA A–1 (concerning the requirement that a specialist use due diligence to ensure that the best available bid and offer is displayed for those option series in which he is assigned); OFPA F–2 (the aforementioned 90-second trade reporting requirement under the Exchange's Minor Rule Plan); and other OFPAs.

[7] *See supra* note 4.

[8] *Id.*

[9] 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 Anne Exline Starr, First Vice President Regulatory Group, Phlx, to John McCarthy, Associate Director, Office of Compliance, Inspections and Examinations (''OCIE''), Commission, and Deborah Lassman Flynn, Assistant Director, Division, Commission, dated January 30, 2002. The Exchange has informed OCIE that it will begin automated surveillance for trade reporting violations no later than April 15, 2002. In the interim period, OCIE will continue to evaluate the Exchange's surveillance, investigatory, and enforcement process to ensure that the Phlx is adequately surveilling and enforcing member compliance with its trade reporting requirements.

[10] In the event that the Exchange discovers through investigation that a single violation or a pattern or practice of violations of Exchange order handling rules is the result of intentional conduct on the part of a member organization, nothing would preclude the Exchange from referring such a matter directly to the Business Conduct Committee for possible disciplinary action.

[11] 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).

[12] 15 U.S.C. 78f(b)(5).

[13] 15 U.S.C. 78f(b)(6).

[14] *See supra* note 9.

[15] 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.

the Commission is accelerating approval of the filing on the twenty-ninth day after publication of the proposed rule change 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. 1 clarifies that ''batching'' of violations can occur only where the Exchange uses automated surveillance to detect violations. In addition, the Commission notes that it received no comments on the proposed rule change. For these reasons, the Commission finds good cause exists, consistent with Sections 6(b)(5)[16] and 19(b)(2) of the Act,[17] to approve the proposed rule change and Amendment No. 1 thereto on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether Amendment No. 1 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 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 Phlx. All submissions should refer to file number SR–Phlx–2001–114 and should be submitted by April 12, 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,[18] that the proposed rule change (SR–Phlx–2001–114) and Amendment No. 1 thereto are approved on an accelerated basis.

[16] 15 U.S.C. 78f(b)(5).

[17] 15 U.S.C. 78s(b)(2).

[18] 15 U.S.C. 78s(b)(2).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[19]

Margaret H. McFarland,

Deputy Secretary.

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[19] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–45569; File No. SR–Phlx–2001–60]

Self-Regulatory Organizations; Order Approving a Proposed Rule Change and Amendment No. 1 Thereto by the Philadelphia Stock Exchange, Inc. Adopting Sanctioning Guidelines for Violations of the Exchange's Order Handling Rules

March 15, 2002.

I. Introduction

On May 31, 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''),[1] and Rule 19b–4 thereunder,[2] a proposed rule change to adopt new sanctioning guidelines to assist the Exchange in enforcing compliance with its options order handling rules.[3] On December 18, 2001, the Exchange filed Amendment No. 1 to the proposed rule change.[4] The proposed rule change, as amended by Amendment No. 1, was published for comment in the **Federal Register** on February 13, 2002.[5] No comments were received on the proposed rule change. This order approves the proposed rule change, as amended.

II. Description of the Proposal

The Exchange proposes to adopt sanctioning guidelines (''Guide'') to assist the various individuals involved in the Exchange's enforcement process, including the Exchange's BCC, by recommending ranges of monetary sanctions to be applied to violations of certain Exchange rules and Option Floor Procedure Advices (''OFPAs''). The Guide covers certain offenses related to the trading of options on the Exchange trading floor, with particular emphasis on options order handling rules.[6] The Guide is proposed as an internal document to be used by the BCC, hearing panels, and the Board of Governors (''Adjudicatory Bodies'') in determining appropriate sanctions to be imposed in formal disciplinary proceedings. The Exchange's enforcement staff may also refer to the Guide in negotiating settlements.

The Exchange has drafted the Guide with an introduction and matrices. The introduction explains the purpose and intent of the Guide and presents an overview of the Exchange's enforcement program, including a description of factors to be considered when sanctioning misconduct in disciplinary proceedings. The matrices cover the Exchange's options order handling rules. Each matrix outlines recommended monetary sanction ranges and specific factors for consideration when a particular options order handling rule has been violated.[7] The proposed Guide would also allow for non-monetary sanctions, such as suspension, expulsion, or other sanctions in egregious cases. The matrices are also arranged by subject matter and trading floor participant (floor broker, registered options trader, specialist).

The proposed Guide would cover only matters brought before the Exchange's BCC, which has jurisdiction over disciplinary actions pursuant to Exchange By-law Article X, Sec. 10–11

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] 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(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'').

[4] *See* letter from Linda S. Christie, Counsel, Phlx, to Deborah Lassman Flynn, Assistant Director, Division of Market Regulation (''Division''), Commission, dated December 17, 2001 (''Amendment No. 1''). In Amendment No. 1, the Exchange amended Phlx Rule 960.10(a) to incorporate the Exchange's Enforcement Sanction Guide by reference into the Exchange's rules. The proposed new language requires the Exchange's Business Conduct Committee (''BCC'') to refer to the Enforcement Sanction Guide for factors to be considered and appropriate sanctions when imposing disciplinary sanctions for violations of the Exchange's option order handling rules.

[5] *See* Securities Exchange Act Release No. 45415 (February 7, 2002), 67 FR 6781.

[6] In addition to filing this proposed Guide, the Exchange has submitted another proposed rule change to adopt guidelines to be used in determining when it is appropriate to aggregate violations of the Exchange's options order handling rules. See Securities Exchange Act Release No. 45421 (February 7, 2002), 67 FR 6961 (February 13, 2002) (SR-Phlx-2001–114).

[7] The Exchange informed Commission staff that the Adjudicatory Bodies would be permitted to consider the entire disciplinary history of the member and, in any event, would be required to consider all violations within the past three years. Telephone conversation between Linda Christie, Counsel, Phlx, and Sonia Patton, Special Counsel, Division, Commission, on March 8, 2002.