

the Act,¹⁰ to approve the proposal on an accelerated basis.

IV. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,¹¹ that the proposed rule change (SR-NASD-2001-88), as amended, is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45416; File No. SR-PCX-2001-23]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Pacific Exchange, Inc. Amending Exchange Rule 6.46 To Adopt New Sanctioning Guidelines for Enforcing Compliance With the Exchange's Options Order Handling Rules

February 7, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 26, 2001, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to adopt new sanctioning guidelines that will assist in effectively enforcing compliance with the Exchange's options order handling rules. The text of the proposed rule change is available at the PCX's Office of the Secretary and at the Commission.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, Proposed Rule Change

(1) Purpose

The Exchange believes that the proposed rule change will assist it in effectively enforcing compliance with its options order handling rules.³ The Exchange represents that it has undertaken to address and will continue to address the importance of compliance with order handling rules such as Best Execution, Limit Order Display, Priority, Firm Quote and Trade Reporting. The proposed rule change sets forth sanctioning guidelines for each separate area of the order handling rules. Each of these areas are discussed in detail below.

The Exchange states that currently, violations of the Exchange 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").⁴ 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 file 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.

The Exchange believes that the proposed guidelines set forth in this filing would serve to assist the Exchange's Regulatory Staff and the Ethics and Business Conduct Committee ("EBCC") in determining appropriate remedial sanctions for violations of all Exchange rules. The Exchange further believes that the proposed guidelines would work to promote consistency and uniformity in the imposition of penalties.⁵ With respect to the order handling rules, the 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. The general principles that apply to all rule violations as well as the particular sanctions relating to the order handling rules are discussed in detail below.

A. General Principles Applicable to All Sanction Determinations

According to the Exchange, the proposed sanctioning guidelines would be used by various Exchange bodies that adjudicate disciplinary actions, including the EBCC, the PCX Board of Governors, the PCX Surveillance and Enforcement Departments, for in-house adjudications (collectively, "Adjudicatory Bodies"), in determining appropriate remedial sanctions. The Exchange believes that it is important to note that the proposed guidelines do not prescribe fixed sanctions for particular violations. Rather, they assist Adjudicatory Bodies in imposing sanctions consistently and fairly. The Exchange believes that the proposed guidelines serve to promote consistency and uniformity in the imposition of penalties by applying the following general principles in connection with the imposition of sanctions in all cases.

(1) Disciplinary sanctions are remedial in nature. The proposed guidelines set forth that the sanctions imposed should be designed to prevent and deter future misconduct.

(2) Progressively escalating sanctions on recidivists. Repeated acts of

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 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 PCX Rule 10.13.

⁵ 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, Commission, dated December 21, 2001.

¹⁰ 15 U.S.C. 78o-3.

¹¹ 15 U.S.C. 78s(b)(2).

¹² 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

misconduct call for increasingly serious sanctions.

(3) Sanctions should be tailored to address the misconduct at issue.

(4) Aggregation or "batching" of violations may be appropriate in certain instances for purposes of determining sanctions. The proposed guidelines would allow for aggregation of several acts of misconduct as one "violation" for purposes of determining sanctions if the misconduct meets certain objective parameters.

(5) Restitution should be ordered if necessary to remediate misconduct.

(6) The amount of ill-gotten gain may be considered when determining sanctions.

(7) Requiring requalification in any or all registered capacities or additional training may also be appropriate.

(8) The inability to pay in connection with the imposition of monetary sanctions may also be considered when determining sanctions.

The proposed guidelines also list several factors that should be considered in conjunction with the imposition of sanctions for specific violations.

B. Sanctions for Violation of Order Handling Rules

1. Firm Quotes—Specialist Options Transactions

The Commission recently amended Rule 11Ac1-1 of the Act,⁶ the "Quote Rule," so that it would apply to the options markets.⁷ In response, the Exchange amended its rules in order to adopt various implementing provisions.⁸ According to the Exchange, it complies with Rule 11Ac1-1 under the Act⁹ by periodically publishing the quotation size for which each Responsible Broker or Dealer¹⁰ on the Exchange is obligated to execute an order to buy or sell an option series that is a reported security at its published bid or offer. The Exchange currently requires that the minimum quotation size for customer orders will be 20 contracts for each option series and for

broker-dealer orders will be one contract for each option series.¹¹

The Exchange now proposes to establish specific sanctioning guidelines relating to disciplinary actions initiated as a result of violations of the PCX Firm Quote Rule 6.86. Along with the general principles enunciated above for determining sanctions, the Exchange proposes to adopt the additional factor of whether the wrongdoer remediated the failure to execute the transaction. The Exchange proposes the following monetary sanctions for disciplinary actions brought for violations of PCX Rule 6.86:

- 1st Disciplinary Action¹²—\$500.00 to \$5,000.00;
- 2nd Disciplinary Action—\$1,000.00 to \$10,000.00; and
- Subsequent Disciplinary Actions—\$3,000.00 to \$50,000.00.

According to the Exchange, the proposed guidelines would also allow for non-monetary sanctions such as suspension, expulsion, or other sanctions in egregious cases. The Exchange believes that the proposed fine levels would help to deter violations of its Firm Quote Rule.

2. Limit Order Display—Specialist Options Transactions

The Exchange currently regulates for display of options bids and offers in its Public Limit Order Book (the "book") under PCX Rule 6.55.¹³ According to the Exchange, PCX Rule 6.55 requires the Order Book Official ("OBO") to continuously display, in a visible manner, the highest bid and lowest offer along with an indication of the number of options contracts bid for at the highest bid and offered at the lowest offer. The Exchange has filed a proposed rule change with the Commission to amend this rule.¹⁴ As amended, the Exchange states that the rule would require an OBO to immediately and continuously display an options limit

order. For the purpose of this rule, "immediately" means as soon as practicable after receipt, which under normal market conditions means no later than 30 seconds after receipt. In its filing to the Commission, the Exchange indicated that the vast majority of these orders are now entered electronically into the OBO's custody when a member firm sends it to the Pacific Options Exchange Trading Systems ("POETS") via the Exchange's Member Firm Interface. The Exchange states that these electronic orders are immediately displayed on the overhead screens on the trading floor and disseminated to the public via OPRA. The Exchange also indicated in its filing that although the rule change would initially apply to Exchange staff only, the Exchange anticipated that in the future, all Exchange members may begin to operate limit order books on the options floor and the modified rule would apply to them. The Exchange states that currently, some Exchange members operate some limit order books; and therefore the amended rule does apply to them. The Exchange ensures that it holds the members responsible for ensuring that the obligations under this rule are met. The Exchange is currently awaiting Commission approval of the proposed amendment to this rule.

In addition, the Exchange proposes to adopt specific sanctioning guidelines relating to disciplinary actions brought for violations of PCX Rule 6.55. Along with the general principles enunciated above, for determining sanctions, the Exchange proposes to adopt additional factors for consideration. These factors include: (1) Whether a customer limit order was executed during the period of non-compliance; (2) whether other transactions were executed at prices equal to or better than the customer limit order; (3) whether the misconduct had a significant adverse impact on market transparency and availability of price information; and (4) the amount of time beyond 30 seconds that elapsed before the limit order was displayed. The Exchange also proposes the following monetary sanctions for disciplinary actions brought for violations of PCX Rule 6.55:

- 1st Disciplinary Action¹⁵—\$1,000.00 to \$5,000.00;
- 2nd Disciplinary Action—\$2,000.00 to \$10,000.00; and

¹⁵ 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.

⁶ 17 CFR 240.11Ac1-1.

⁷ See Securities Exchange Act Release No. 43591 (November 17, 2000), 65 FR 75439 (December 1, 2000).

⁸ See Securities Exchange Act Release No. 44145 (June 1, 2001), 66 FR 30959 (June 8, 2001) (SR-PCX-2001-18).

⁹ 17 CFR 240.11Ac1-1.

¹⁰ The Exchange defines "Responsible Broker or Dealer" as "with respect to any bid or offer for any listed option made available by the Exchange to quotation vendors, the Lead Market Maker and any registered Market Makers constituting the trading crowd in such option series will collectively be the Responsible Broker or Dealer to the extent of the aggregate quotation size specified." See PCX Rule 6.86(a)(2).

¹¹ See PCX Rules 6.86(b) & (c).

¹² 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. See telephone conversation between Hassan A. Abedi, Manager, Enforcement, PCX, and Sonia Patton, Staff Attorney, Commission, on February 6, 2002.

¹³ The Exchange filed with the Commission a proposed rule change to amend PCX Rule 6.46 in order to assure that Floor Brokers promptly display limit orders that improve the market. See File No. SR-PCX-2001-40 (October 18, 2001).

¹⁴ See Securities Exchange Act Release No. 43550 (November 13, 2000), 65 FR 69979 (November 21, 2000) (SR-PCX-00-15).

Subsequent Disciplinary Actions—\$5,000.00 to \$50,000.00.

According to the Exchange, the proposed guidelines would also allow for non-monetary sanctions such as suspension, expulsion, or other sanctions in egregious cases. The Exchange believes that the proposed fine levels would help to deter violations of its Limit Order Display Rule.

3. Priority Rules—Obligations of Market Makers and Priority of Bids and Offers

According to the Exchange, PCX Rules 6.37 and 6.75 currently set forth the Obligations of Market Makers and the Priority of Bids, respectively. The Exchange states that it submitted a proposed rule change to amend these rules with the Commission pursuant to the requirements of the Order.¹⁶

According to the Exchange, the purpose of this proposed amendment is to adopt new rules pertaining to the allocation of option orders on the trading floor, priority of bids and offers on the trading floor, and the spreads or options prices established by Market Makers. In that same submission, the Exchange states that it also seeks Commission approval of an Exchange Regulatory Bulletin that is intended to summarize and clarify the Exchange rules relating to priority of bids and offers on the options trading floor and the allocation of orders in response to bids and offers that have been accepted by other floor members.¹⁷

The Exchange now proposes to adopt specific sanctioning guidelines relating to disciplinary actions brought for violations of PCX Rules 6.37 and 6.75. Along with the general principles enunciated above to be considered when determining sanctions, the Exchange proposes to adopt additional factors for consideration. These factors include: (1) Whether the misconduct involved violations of rules intended to provide protection to customer orders; (2) whether the misconduct resulted in the failure to execute a customer order; and (3) if so, whether the wrongdoer remediated the misconduct. The Exchange also proposes the following monetary sanctions for disciplinary actions brought for violations of PCX Rules 6.37 and 6.75:

1st Disciplinary Action¹⁸—\$1,000.00 to \$5,000.00;

¹⁶ File No. SR-PCX-2001-50.

¹⁷ *Id.*

¹⁸ 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.

2nd Disciplinary Action—\$2,000.00 to \$20,000.00; and

Subsequent Disciplinary Actions—\$5,000.00 to \$50,000.00.

According to the Exchange, the proposed guidelines would also allow for non-monetary sanctions such as suspension, bar, or other sanctions in egregious cases. The Exchange believes that the proposed fine levels will help to deter violations of its Priority Rules.

4. Best Execution—Floor Broker's Use of Due Diligence in Handling Orders

The Exchange currently sanctions members and member organizations for violations of its best execution rules under the Exchange's MRP. As previously discussed, although these violations are governed by the MRP, the Exchange states that it has authority to remove a specific violation from the MRP and treat it as a formal disciplinary action.

The Exchange states that it enforces the obligations of best execution, with respect to handling of orders, under PCX Rule 6.46, which requires a floor broker handling an order to use due diligence to execute the order at the best price or prices available. According to the Exchange, a floor broker's use of due diligence in executing an order includes ascertaining whether a better price than that being displayed at that time is being quoted by another floor broker or market maker. The floor broker must also make all persons in the trading crowd aware of his request for a quotation. Finally, the Exchange states that it requires all floor brokers to immediately and continuously represent market and marketable orders at the trading post and execute the order in a prompt manner.

As stated by the Exchange, violations of PCX Rule 6.46 are currently enforced under the Exchange's MRP.¹⁹ The Exchange, in an effort to encourage compliance with and deter future violations of its MRP rules, filed with and received approval from the Commission to increase the fines that it imposes under its MRP.²⁰ The current fines being imposed by the Exchange for violations²¹ of Rule 6.46 are listed below.

Minor Rule Plan

1st Violation—\$1,000.00

2nd Violation—\$2,500.00

3rd Violation—\$3,500.00

¹⁹ See PCX Rule 10.13(k)(i)(1).

²⁰ See Securities Exchange Release Act No. 44010 (February 27, 2001), 66 FR 13618 (March 6, 2001) (SR-PCX-00-37).

²¹ According to the Exchange, fines for multiple violations are calculated on a running two-year basis pursuant to its MRP.

In order to provide guidance to its Adjudicatory Bodies, the Exchange proposes to adopt specific sanctioning guidelines relating to formal disciplinary actions, outside of the MRP, brought for violations of PCX Rule 6.46. Along with the general principles enunciated above for determining sanctions, the Exchange proposes to adopt additional factors for consideration. These factors include: (1) Whether the misconduct involved violations of rules intended to provide protection to customer orders; (2) whether a customer was disadvantaged because of the floor broker's failure to exercise due diligence; (3) whether the misconduct resulted in the failure to execute a customer order; (4) if so, whether the wrongdoer remediated the misconduct; and (5) whether the wrongdoer acted with intent to disadvantage a customer. In addition, the Exchange proposes the following monetary sanctions for disciplinary actions brought for violations of PCX Rule 6.46:

1st Disciplinary Action²²—\$1,000.00 to \$5,000.00;

2nd Disciplinary Action—\$3,000.00 to \$10,000.00; and

Subsequent Disciplinary Actions—\$10,000.00 to \$25,000.00.

The Exchange believes that the increased focus of its regulatory staff in this area, combined with the increased fines in its MRP, as well as the proposed guidelines, which will also allow for non-monetary sanctions such as suspension, bar, or other sanctions in egregious cases will assist in reducing the number and deterring future violations of member and member organization best execution obligations.

5. Trade Reporting—PCX Rule 6.69 Reporting Duties

The Exchange currently sanctions members and member organizations for violations of its trade reporting rules under the PCX MRP. As previously discussed, although these violations are governed by the MRP, the Exchange has authority to remove a specific violation from the MRP and treat it as a formal disciplinary action.

As stated above, violations of PCX Rule 6.69 are currently enforced under the Exchange's MRP.²³ PCX Rule 6.69 sets forth the trade reporting duties of its members and member organizations.

²² 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.

²³ See PCX Rule 10.13(k)(i)(38).

The Exchange recently amended PCX Rule 6.69 in order to clarify and reinforce the reporting obligations of its members and member organizations.²⁴ As amended, the PCX Rule 6.69(a) requires that all option transactions be immediately reported to the Exchange for dissemination to the Options Price Reporting Authority ("OPRA").²⁵ PCX Rule 6.69(a) applies to all members and member organizations that are required to report trades either directly to OPRA or to another party who is responsible for reporting trades to OPRA. According to the Exchange, transactions not reported to OPRA within 90 seconds after execution are designated as "late." The Exchange further states that under its MRP, members and member organizations who violate this rule are currently sanctioned in the following manner:

Minor Rule Plan

1st Violation—\$100.00;
2nd Violation—\$250.00; and
3rd Violation—\$500.00.

The Exchange intends to amend its MRP in order to increase the sanctions for trade reporting violations. The increased sanctions will be similar to those submitted by the Exchange in the previous amendment to the MRP.²⁶ The Exchange believes that the increased fines will assist in deterring future violations of its trade reporting rule.

On November 19, 2001, the Commission approved a rule change by the Exchange that requires all Exchange member organizations to synchronize their business clocks.²⁷ In sum, this rule requires Exchange members to ensure that the business clocks they use at the Exchange are accurate to within three seconds of the National Institute of Standards and Technology Atomic Clock in Boulder, Colorado, or the United States Naval Observatory Master Clock in Washington, DC. The Exchange states that this rule allows the Exchange members to generate more accurate automated reports and should assist members in reducing the number of reporting violations that might occur if

their business clocks were not synchronized.

The Exchange states that in order to provide guidance to its Adjudicatory Bodies, it proposes to adopt specific sanctioning guidelines relating to formal disciplinary actions, outside of the MRP, brought for violations of PCX Rule 6.96. Along with the general principles enunciated above, for determining sanctions, the Exchange proposes to adopt additional factors for consideration. These factors include: (1) The extent of the abuse (*i.e.*, whether a pattern of abuse exists, and the number of transactions involved); (2) presence of intent, recklessness, or negligence; (3) the nature of trade-reporting violation; (4) whether the violative conduct affected discovery of information regarding market price; (5) the amount of time beyond 90 seconds that elapsed before trade was reported; and (6) whether the wrongdoer remediated the misconduct. In addition, the Exchange proposes the following monetary sanctions for disciplinary actions brought for violations of PCX Rule 6.69: 1st Disciplinary Action²⁸—\$1,000.00 to \$5,000.00; 2nd Disciplinary Action—\$3,000.00 to \$10,000.00; and Subsequent Disciplinary Actions—\$10,000.00 to \$50,000.00.

The Exchange believes that these undertakings would help to prevent fraudulent and manipulative acts and practices as well as to promote just and equitable principles of trade. The Exchange also believes that these tools would enable the Exchange to provide timely trade information to investors more efficiently. Finally, the enhanced transparency associated with timely trade reporting should facilitate price discovery for investors and assist the Exchange's surveillance of its members' trading in listed options.

(2) Statutory Basis

The Exchange believes that this proposal is consistent with Section 6(b) of the Act,²⁹ in general, and furthers the objectives of Section 6(b)(5),³⁰ in particular, in that it is designed to facilitate transactions in securities, to promote just and equitable principals of trade, and to protect investors and the public interest.

²⁸ 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.

²⁹ 15 U.S.C. 78f(b).

³⁰ 15 U.S.C. 78f(b)(5).

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

Written comments on the proposed rule change were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which the Exchange consents, the Commission will:

A. By order approve such proposed rule change; or

B. Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change 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 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 filings will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-PCX-2001-23 and should be submitted by March 6, 2002.

²⁴ See Securities Exchange Release Act No. 43975 (February 15, 2001), 66 FR 11624 (February 26, 2001) (SR-PCX-00-27).

²⁵ According to the Exchange, OPRA disseminates the options exchanges' best bid and offering price, but does not disseminate the sizes of those markets. However, the size of the best bid and offer in the book is displayed on the overhead screens on the floor. See PCX Rule 6.55.

²⁶ See Securities Exchange Release Act No. 44010 (February 27, 2001), 66 FR 13618 (March 6, 2001) (SR-PCX-00-37).

²⁷ See Securities Exchange Release Act No. 45080 (November 19, 2001), 66 FR 59281 (November 27, 2001) (SR-PCX-2001-24).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.³¹

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45415; File No. SR-Phlx-2001-60]

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

February 7, 2002.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on May 31, 2001, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On December 18, 2001, the Exchange filed Amendment No. 1 to the proposed rule change.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to adopt sanctioning guidelines ("Guide") to assist the various individuals involved in the Exchange's enforcement process, including the Exchange's Business Conduct Committee ("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.⁴ The text of the proposed rule change is available at the Phlx's Office of the Secretary and at the Commission.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(1) Purpose

According to the Exchange, the Guide is proposed as an internal document to be used by the BCC, hearing panels, and the Board of Governors in determining appropriate sanctions to be imposed in formal disciplinary proceedings. The Exchange states that its enforcement staff may also refer to the Guide in negotiating settlements. The Exchange believes that the criteria outlined in the Guide are designed to promote consistency in sanctions, and to effectively enforce compliance with the Exchange's option order handling rules.⁵

⁴ 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 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"). In addition to filing this Guide, the Exchange has submitted another proposed rule change (SR-Phlx-2001-114) to adopt guidelines to be used in determining when it is appropriate to aggregate violations of the Exchange's options order handling rules.

⁵ 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, Commission, and Deborah Lassman Flynn, Assistant Director, Division, Commission, dated January 30, 2002.

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. The matrices are also arranged by subject matter and trading floor participant (floor broker, registered options trader, specialist).⁶

The Exchange states that the Guide would cover only matters brought before its BCC, which has jurisdiction over disciplinary actions pursuant to Exchange By-law Article X, Sec. 10-11 and Exchange Rule 960.1. According to the Exchange, the Guide would not apply to violations charged under its minor rule violation enforcement and reporting plan, which consists of Exchange Rule 970 and the corresponding OFPA.⁷

(2) Statutory Basis

The Exchange believes that the proposed rule change is consistent with section 6(b) of the Act,⁸ in general, and furthers the objectives of section 6(b)(5) of the Act,⁹ in particular, in that it is designed to promote just and equitable principles of trade, and to remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect the investors and the public interest, because it should provide an appropriate form of deterrence for violation of Exchange rules, particularly the options order handling rules.

In addition, the Exchange believes that the proposed rule change is

⁶ Although the Guide is being filed as a proposed rule change pursuant to the Order, the Exchange does not intend to file amendments to the Guide with the Commission as proposed rule changes hereafter, because the Guide is a document for internal use only and proposes guidelines that are not binding.

⁷ According to the Exchange, the OFPAs contain fine schedules to be applied when minor violations are detected. The Exchange states that the fine schedules associated with the OFPAs are administered pursuant to Exchange Rule 970, which codifies the Exchange's minor rule violation enforcement and reporting plan. Exchange Rule 19d-1(c)(1) requires the prompt reporting with the Commission of any final disciplinary action. However, the Exchange believes that minor rule violations not exceeding \$2,500 are not deemed final and therefore not subject to the same reporting requirements.

⁸ 15 U.S.C. 78f(b).

⁹ 15 U.S.C. 78f(b)(5).

³¹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 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 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.