

provides that if any portion of Paragraph C. of Article Fourth of the Certificate is found to be invalid, the validity of remaining provisions shall not be affected. Nasdaq proposes to amend the paragraph to include conforming references to the Notes.

Article Ninth

Nasdaq proposes to amend this article to provide that a two-third vote of the holders of outstanding Notes is required: (1) To amend Paragraph C. of Article Fourth of the Certificate in a manner that would adversely affect the rights of the holders of the Notes without similarly affecting the rights of stockholders; or (2) to amend such two-thirds voting requirements.

Article Eleventh

This article authorizes the Nasdaq Board of Directors to consider the effect of proposed corporate action on enumerated aspects of Nasdaq's regulatory obligations. Nasdaq proposes to amend the provision to include conforming references to the Notes.

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 association.⁹ In particular, the commission believes the proposal is consistent with the requirements of Sections 15A(b)(2) and (6) of the Act,¹⁰ which require, among other things, that the Association be so organized and have the capacity to be able to carry out the purposes of the Act and to comply with, and enforce compliance with, the provisions of the Act, and that the Association's rules are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

The purpose of this filing is ensure that the holders of the Notes are granted the same voting rights, and are subject to the same limitations, as the holders of common stock. Therefore, in reviewing this filing, it is instructive to consider the commission's original findings in approving the Certificate.¹¹ In its order approving the Certificate, the Commission found that the 5%

voting limitation and other limitations affecting the control of Nasdaq fulfill the obligations arising under sections 15A(b)(2) and (6). Specifically, the Commission noted that the limitation on voting shares owned in excess of 5% satisfies the requirements of Section 15A(b)(6) because it helps to avoid a situation where the integrity of Nasdaq might be compromised if the NASD had to choose between taking action against a broker or dealer that owned, and could vote, Nasdaq shares in excess of 5%, and fulfilling its self-regulatory responsibilities.

The Commission believes that the changes proposed to Nasdaq's Certificate in this filing are consistent with maintaining the 5% voting limitation that is currently contained in the Certificate, which serves the public interest by ensuring that certain individuals and entities cannot gain undue influence over the operations of Nasdaq, and are therefore consistent with sections 15A(b)(2) and (6).

The Commission also finds that the provision that would exempt HFCEP IV LPs from the 5% voting limitation if the Nasdaq Board of Directors approves an exemption from the 5% voting limitation for any other person (other than an exemption granted in connection with the establishment of a strategic alliance with another exchange or similar market) is consistent with section 15A(b)(6) of the Act. The commission notes that as originally approved, the Certificate provided that the Board could grant exemptions from the voting limitation if certain conditions were met.¹² The proposed amendments do not alleviate or in any way change those conditions. They simply provide that if the Board finds it appropriate to approve an exemption for one person or entity, it must also grant the exemption to HFCEP IV LPs assuming they meet the same conditions (unless the exemption discussed above for

establishment of a strategic alliance applies).

IV. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act¹³ that the proposed rule change (SR-NASD-2001-34) is approved.

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

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45136; File No. SR-NYSE-2001-43]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the New York Stock Exchange, Inc. Amending Paragraph (1) of the Guidelines to Exchange Rule 105 To Permit Approved Persons of Specialists to Act as a Specialist With Respect to an Option on a Specialty Stock

December 6, 2001.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 and ("Act"),¹ Rule 19b-4 thereunder,² notice is hereby given that on October 18, 2001, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Exchange filed Amendment No. 1 to the proposed rule change on December 4, 2001.³ The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

¹ 15 U.S.C. 78s(b)(2).

¹⁴ 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 James E. Buck, Senior Vice President and Secretary, NYSE, to Nancy Sanow, Assistant Director, Division of Market Regulation, Commission, dated December 3, 2001 ("Amendment No. 1"). In Amendment No. 1, the NYSE decided to keep the portion of paragraph (l)(ii) of the Guidelines to NYSE Rule 105, which prohibits an approved person affiliated with an NYSE specialist that acts as an options market maker and any other approved person of the specialist from acting as a market maker in any equity security in which the associated specialist is registered as such and which underlies an option to which the approved person acts as an options market maker.

⁹ In approving this rule proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁰ 15 U.S.C. 78o-3(b)(2) and (6).

¹¹ See Securities Exchange Act Release No. 42983 (June 26, 2000), 65 FR 41116 (July 3, 2000) (File No. SR-NASD-00-27).

¹² Specifically, the Certificate provides that in no event shall an exemption from the scaled voting provision be granted to (1) a registered broker or dealer, or an affiliate thereof, or (2) an individual or entity subject to statutory disqualification under section 3(a)(39) of the Act. The Board may approve an exemption from the scaled voting provision if the Board determines that granting the exemption would (1) Not reasonably be expected to diminish the quality of, or public confidence in, the Nasdaq Stock Market or other operations of Nasdaq, on the ability to prevent fraudulent and manipulative acts and practices and on investors and the public, and (2) promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities or assist in the removal of impediments to or perfection of the mechanisms for a free and open market and a national market system.

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

The NYSE proposes to amend paragraph (1) of the Guidelines to NYSE Rule 105 to permit an approved person of a specialist to act as a specialist or primary market maker with respect to an option on a stock in which the specialist acts as a market maker on the Exchange ("specialty stock"), provided that all of the requirements of the NYSE Rule 98 exemptive program are met.

The text of the proposed rule change appears below. New text is in *italics*; deletions are in brackets.

Guidelines for Specialists' Specialty Stock Option Transactions Pursuant to Rule 105

(a) through (k)—No change

* * * * *

(l) Specialist Shall Not Be Options Market-Maker

* * * * *

(ii) Notwithstanding the above, an approved person of an equity specialist entitled to an exemption from this rule under Rule 98 may act as a competitive market-maker, competitive options trader, registered options trader, or *as a specialist or market-maker* [in a similar non-primary market-making capacity] in any option as to which the underlying security is a stock in which the associated specialist is registered as such; provided, however, that if an approved person is so acting as an options market maker pursuant to this paragraph, neither that approved person, nor any other approved person of the specialist, may act as a market maker in any equity security in which the associated specialist is registered as such and which underlies an option as to which the approved person acts as an options market maker.

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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 next 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

NYSE Rule 105 provides that an "approved person" (*i.e.*, an affiliate in a control relationship) of a specialist organization may trade options on a specialty stock only for hedging purposes. If the approved person establishes a system of internal controls and information barriers pursuant to Exchange Rule 98, however, the approved person may engage in proprietary trading of specialty stock options without being restricted solely to hedging transactions.

Currently, even with an NYSE Rule 98 exemption, an approved person of a specialist may not act as a specialist or primary market maker with respect to an option on a specialty stock. Such approved person of a specialist may, however, act as a competitive or non-primary market maker in a specialty stock option. According to the Exchange, the prohibition on acting as an options specialist or primary market maker has been rooted, historically, in concerns about the perception of an inherent conflict of interest, as there is a direct pricing relationship between a stock and its associated option.

The Exchange believes that on-going consolidation within the securities industry makes it likely that large, well-capitalized, well-regulated organizations may seek to conduct distinct business operations among several affiliated entities. The concerns about possible conflicts of interest as between stock and option market making continue to exist, but the Exchange believes that they can be effectively addressed pursuant to the NYSE Rule 98 exemptive program. The Exchange believes that its experience with this program has demonstrated the viability of "functional regulation" whereby affiliated entities conduct distinct lines of business with strict information barriers between them. Under the NYSE Rule 98 program, specialists and their affiliates must present their proposed operating model to the Exchange for prior approval, and are thereafter, subject to annual NYSE examination. The Exchange states that the NYSE Rule 98 program has been in effect for more than 15 years, and forwards that there have been no instances of a material breach of information barriers.

The Exchange now proposes to amend paragraph (1) of the Guidelines to NYSE Rule 105 to permit an approved person of a specialist to act as a specialist or primary market maker with respect to

an option on a specialty stock, provided all requirements of the NYSE Rule 98 exemptive program are met. Thus, among other matters, the approved person must (i) conduct its operations in a legal entity that is separate and distinct from the Exchange equity specialist; (ii) maintain separate and distinct books and records and its own, separately dedicated capital; (iii) maintain strict information barriers between itself and the affiliated Exchange equity specialist regarding trading and position information; (iv) conduct its day to day business with its own staff; and (v) make all trading decisions independent of the Exchange equity specialist.

The Exchange believes that these safeguards are sufficient to address potential conflict of interest problems, while ensuring that the separate entities remain subject to meaningful functional regulation.

(2) Statutory Basis

The Exchange believes the basis for the proposed rule change, as amended, is the requirement under section 6(b)(5) of the Act⁴ that an exchange have rules that are designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.

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

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

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

The Exchange has neither solicited nor received written comments on the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Time 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 reason for so finding, or (ii) as to which the Exchange consents, the Commission will:

⁴ 15 U.S.C. 78f(b)(5).

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, as amended, 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 filings will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-NYSE-2001-43 and should be submitted by January 2, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁵

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45132; File No. SR-Phlx-2001-107]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to an Extension of the Interim Intermarket Linkage Program

December 5, 2001.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act of 1934"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on November 29, 2001, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission")

the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the self-regulatory organization. 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 Phlx, pursuant to Rule 19b-4 under the Act, proposes to extend the pilot program authorizing implementation of "interim linkages" with the other options exchanges.³

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. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in section 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

The purpose of the proposed rule change is to request an extension of an intermarket options linkage on an "interim" basis. Currently, the Exchange is operating this interim linkage as a pilot program pursuant to Phlx Rule 1081. The interim linkage utilizes existing market infrastructure to facilitate the sending and receiving of order flow between Phlx Specialists, and may later include Registered Options Traders, and their counterparts on the other options exchanges as an interim step towards development of a "permanent" linkage. The Exchange now proposes that the interim linkage would remain in effect on a pilot basis until April 1, 2002.

By way of background, the Commission has approved a linkage plan that now includes all five options exchanges.⁴ The options exchanges

continue to work towards implementation of this linkage, including contracting with a third party to build a linkage infrastructure. In the meantime, the options exchanges have implemented this interim linkage.

The key component of the interim linkage is the participating exchanges opening their automated customer execution systems, on a limited basis, to market maker orders. Specifically, market makers, such as Phlx Specialists, and later Registered Options Traders, are able to designate certain orders as "customer" orders, and thus, receive execution under the automatic execution parameters of participating exchanges pursuant to the interim linkage.⁵

The interim linkage authorizes the Phlx to implement bilateral or multilateral interim arrangements with the other exchanges to provide for equal access between market makers on our respective exchanges. Currently the interim linkage pilot program allows Phlx Specialists and their equivalents on the other exchanges, when they are holding customer orders, to send orders reflecting the customer orders to the other market for execution when the other market has a better quote. Such orders are limited in size to the lesser of the size of the two markets' "firm" quotes for customer orders. The Exchange expects that the interim linkage may expand to include limited access for pure principal orders of no more than 10 contracts.

Under the rules of the pilot program, all interim linkage orders must be "immediate or cancel" (that is, they cannot be placed on an exchange's limit order book), and a market maker can send a linkage order only when the other (receiving) market is displaying the best national bid or offer and the sending market is displaying an inferior price. This allows a Phlx Specialist to access the better price for its customer. In addition, if the interim linkage includes principal orders, it would allow market makers to attempt to "clear" another market displaying a superior quote.⁶

Phlx Specialists' participation in the interim linkage is voluntary. Only when a Phlx Specialist and their equivalent on another exchange believe that this form

³ On May 16, 2001, the Commission issued a notice of filing and immediate effectiveness of a pilot program submitted by the Phlx authorizing the implementation of an interim linkage. See Securities Exchange Act Release No. 44311, 66 FR 28768 (May 24, 2001).

⁴ See Securities Exchange Act Release Nos. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000); 43573 (November 16, 2000), 65 FR 70850 (November 28, 2000); and 43574 (November 16, 2000), 65 FR 70851 (November 28, 2000).

⁵ As with other orders that are executed under the automatic execution parameters of the Exchange, when a limit order constitutes the Exchange's best bid or offer, the specialist executes the incoming order against that order.

⁶ The Commission continues to expect that any exchange participating in the interim linkage will implement heightened surveillance procedures to help ensure that their respective market makers send only properly-qualified orders through the interim linkage.

⁵ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240-19b-4.