

extent of modification necessary to integrate their systems into the central hub and beginning to modify those systems.

The Commission has twice extended the compliance date of the Trade-Through Disclosure Rule for broker-dealers, most recently until April 1, 2002, because of its reluctance to impose on broker-dealers the costs of complying with the disclosure requirements of the rule while the Options Exchanges are working to implement the Linkage Plan, which would render such disclosures unnecessary.⁶ Recently the Options Exchanges, in a letter dated March 15, 2002 to Chairman Pitt, committed to implement the linkage in two phases by specified dates.⁷ The first phase would comprise those elements of the linkage that are necessary to send and receive orders required under the Linkage Plan to be automatically executed by the exchange receiving the order. The Options Exchanges committed to begin full intermarket testing of the first phase by December 1, 2002, and to implement this phase no later than February 1, 2003. The second phase would comprise the remaining elements of the linkage. The exchanges commit to begin testing of this second phase by March 1, 2003, and to implement this phase no later than April 30, 2003. The Options Exchanges also committed to file with the Commission an amendment to the Linkage Plan that would incorporate this testing and implementation timetable.⁸

In addition, the Options Exchanges agreed to file an amendment to the Linkage Plan that would permit an exchange to withdraw from participation in the Linkage Plan only if it can satisfy the Commission that it can accomplish, by alternative means, the same goals as the Linkage Plan of limiting intermarket trade-throughs of prices on other markets.⁹ The Options Exchanges are currently working on amendments to the Linkage Plan that would be approved by each of their boards and filed with the Commission by April 15, 2002. If the Commission approves the amendments to the Linkage Plan,¹⁰ the principal purpose of

the Trade-Through Disclosure Rule “to require customers” orders to be executed on exchanges that participate in a linkage that limits intermarket trade-throughs or, in the alternative, to provide customers with additional information about the execution of their orders “would be accomplished.

Accordingly, the Commission believes that it is appropriate in the public interest and consistent with the protection of investors at this time to temporarily exempt broker-dealers from the requirements of the Trade-Through Disclosure Rule. Moreover, in light of the expressed intent of the Options Exchanges to file amendments to the Linkage Plan so that no exchange may withdraw from its obligations to limit trade-throughs of prices on other markets without an alternative means to achieve this same goal, the Commission has directed the staff to develop a proposal so that the Commission may consider repeal of the Trade-Through Disclosure Rule. At the time the Commission considers the proposal to repeal the Trade-Through Disclosure Rule it has directed staff to develop, it will consider a further extension of this temporary exemption.

Accordingly,

It is ordered, pursuant to section 36 of the Exchange Act,¹¹ that broker-dealers are exempt from compliance with the Trade-Through Disclosure Rule until July 1, 2002.

By the Commission.

Margaret H. McFarland,
Deputy Secretary.

[FR Doc. 02-7902 Filed 4-1-02; 8:45 am]

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submit written comments. See Exchange Act Rule 11Aa3-2(c)(1), 17 CFR 11Aa3-2(c)(1). A proposed amendment may be put into effect summarily upon publication of notice, on a temporary basis not to exceed 120 days, if the Commission finds that such action is necessary or appropriate in the public interest, for the protection of investors or the maintenance of fair and orderly markets, to remove impediments to, and perfect mechanisms of, a national market system or otherwise in furtherance of the purposes of the Exchange Act. See Exchange Act Rule 11Aa3-2(c)(4), 17 CFR 11Aa3-2(c)(4). Within 120 days of publication of notice of filing of an amendment to the Linkage Plan, the Commission must approve the amendment, with such changes or subject to such conditions as the Commission may deem necessary or appropriate, if it finds that such amendment is necessary or appropriate in the public interest, for the protection of investors and the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanisms of, a national market system, or otherwise in furtherance of the purposes of the Exchange Act. See Exchange Act Rule 11Aa3-2(c)(2), 17 CFR 11Aa3-2(c)(2).

¹¹ 15 U.S.C. 78mm.

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45650; File No. SR-Amex-2001-72]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval to Proposed Rule Change and Amendment Nos. 1 and 2 by the American Stock Exchange LLC Relating to an Expansion of the Hedge Exemption From Position and Exercise Limits

March 26, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934,¹ notice is hereby given that on September 6, 2001, the American Stock Exchange LLC (“Amex” 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. On December 26, 2001, the Exchange filed Amendment No. 1² with the Commission, and on February 4, 2002, the Exchange filed Amendment No. 2³ with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change and Amendment Nos. 1 and 2 from interested persons. The Commission is also granting accelerated approval to the proposed rule change, including Amendment Nos. 1 and 2.

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

The Exchange is proposing to amend Commentary .09 to Amex Rule 904 to eliminate position and exercise limits for certain qualified hedge strategies relating to stock and Exchange-Traded Fund (“ETF”) Share options and to establish a position and exercise limit of five times the standard limit for those strategies that include an OTC option

¹ 15 U.S.C 78s(b)(1).

² See Letter to Sharon Lawson, Senior Special Counsel, Division of Market Regulation (“Division”), Commission, from Jeffrey P. Burns, Senior Counsel, Amex, dated December 21, 2001 (“Amendment No. 1”). In Amendment No. 1, Amex amended the proposed rule change to state that for back-to-back options or where one of the option components of a qualified hedge consists of an over-the-counter (“OTC”) option, the hedge exemption is limited to five times the established position limit.

³ See Letter to Sharon Lawson, Senior Special Counsel, Division, Commission, from Jeffrey P. Burns, Senior Counsel, Amex, dated February 1, 2002 (“Amendment No. 2”). Amendment No. 2 is a technical amendment whereby the Exchange moved language regarding the establishment of position and exercise limit of five times the standard limit for those strategies that include an OTC option contract to the beginning to Commentary .09 to Amex Rule 904.

⁶ See Securities Exchange Act Release Nos. 44078 (March 15, 2001), 66 FR 15792 (March 21, 2001); and 44852 (September 26, 2001), 66 FR 50103 (October 2, 2001).

⁷ See Letter from the Options Exchanges to Harvey L. Pitt, Chairman, Securities and Exchange Commission, dated March 15, 2002.

⁸ See Exchange Act Rule 11Aa3-2(d), 17 CFR 11Aa3-2(d).

⁹ *Id.*

¹⁰ The Commission must publish any amendment to the Linkage Plan filed by the Options Exchanges and provide interested persons an opportunity to

contract. The current reporting procedures that serve to identify and document hedged positions will continue to apply.

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 Amex 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 Amex 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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

Amex is proposing to eliminate position and exercise limits when certain qualified strategies are employed to establish a hedged equity option position and to establish a position and exercise limit of five times the standard limit for those strategies that include an OTC option contract. Position limits impose a ceiling on the aggregate number of options contracts (when long or short) of each class on the same side of the market that can be held or written by an investor or group of investors acting in concert. Exercise limits prohibit the exercise by an investor or group of investors acting in concert of more than a specified number of options contracts in a particular underlying security within five (5) consecutive business days. The Exchange believes that this proposal expands position and exercise limits to meet the needs of investors for market neutral strategies. This expansion of the Equity Hedge Exemption from position and exercise limits (the "Equity Hedge Exemption") is substantially identical to proposals recently filed by the Chicago Board Options Exchange, Inc. ("CBOE")⁴ and the Pacific Stock Exchange, Inc. ("PCX").⁵

⁴ See Securities Exchange Act Release No. 44681 (August 10, 2001), 66 FR 43274 (August 17, 2001) (SR-CBOE-00-12). The CBOE's proposed qualified hedge strategies contain certain examples of the strategies. See Amendment No. 1 to SR-CBOE-00-12. The Amex represents that the CBOE's examples apply equally to the Amex's proposed qualified hedge strategies.

⁵ See Securities Exchange Act Release No. 44680 (August 10, 2001) 66 FR 43283 (August 17, 2001) (SR-PCX-00-45).

Current Commentary .07 to Amex Rule 904 provides position and exercise limits for stock and ETF Share options of 13,500, 22,500, 31,500, 60,000 and 75,000 options contracts on the same side of the market depending on the level of underlying trading volume over a six-month period.⁶ The existing hedge exemption found in Commentary .09 to Amex Rule 904 provides an exemption to position and exercise limits of up to three (3) times the standard limit for certain qualified hedge strategies as follows: (i) Long call and short stock; (ii) short call and long stock; (iii) long put and long stock; and (iv) short put and short stock.⁷ Moreover, in 1993 the Amex expanded the definition of a qualified hedge position to allow for the use of convertible securities.⁸

Since the inception of the Equity Hedge Exemption in 1988,⁹ the types of hedge strategies employed by market participants have become increasingly more diversified. Amex believes that, through its experience in administering and processing Equity Hedge Exemption information, it has learned that market participants no longer rely strictly on a stock-option hedge. Additionally, while traditional hedge strategies such as a covered call or reverse conversion strategy continue to be utilized, the Amex believes that listed options contracts are now employed to hedge a wider spectrum of securities.

In response to the Commission's liberalization in granting position limit relief for market neutral strategies, and to more fully accommodate the hedging needs of investors, the Exchange is proposing to eliminate position and exercise limits when certain qualified strategies are employed to establish a hedged equity options position. Accordingly, the Amex proposes to expand the definition of a "qualified hedged position" found in Commentary .09 to Amex Rule 904. The proposed qualified hedged strategies are as follows:

1. Where each option contract is "hedged" by the number of shares underlying the option contract or securities convertible into the underlying security or, in the case of an adjusted option, the same number of shares represented by the adjusted contract: (a) Long call and short stock;

⁶ See Securities Exchange Act Release No. 40875 (December 31, 1998), 64 FR 1842 (January 12, 1999).

⁷ See Securities Exchange Act Release No. 25738 (May 24, 1988), 53 FR 20201 (June 2, 1988).

⁸ See Securities Exchange Act Release No. 36409 (October 23, 1995), 60 FR 55399 (October 31, 1995) and Securities Exchange Act Release No. 32902 (September 14, 1993), 58 FR 49066 (September 21, 1993).

⁹ See *supra* note 8.

(b) short call and long stock; (c) long put and long stock; or (d) short put and short stock.

2. *Reverse Conversions*—A long call position accompanied by a short put position, where the long call expires with the short put and the strike price of the long call and short put is the same, and where each long call and short put contract is hedged with 100 shares (or other adjusted number of shares) of the underlying security or securities convertible into such underlying security.¹⁰

3. *Conversions*—A short call position accompanied by a long put position, where the short call expires with the long put and the strike price of the short call and long put is the same, and where each short call and long put contract is hedged with 100 shares (or other adjusted number of shares) of the underlying security or securities convertible into such underlying security.¹¹

4. *Collars*—A short call position accompanied by a long put position, where the short call expires at the same time as the long put and the strike price of the short call equals or exceeds the strike price of the long put position and where each short call and long put position, is hedged with 100 shares of the underlying security (or other adjusted number of shares).¹² Neither side of the short call/long put position can be in-the-money at the time the position is established.

5. *Box Spreads*—A long call position accompanied by a short put position, where both the long call and short put have the same strike price, and a short call position accompanied by a long put position, where the short call and long put have the same strike price as each other, but a different strike price than the long call/short put position.

6. *Back-to-Back Options*—A listed option position hedged on a one-for-one basis with an over-the-counter ("OTC") option position on the same underlying security.¹³ The strike price of the listed

¹⁰ For these strategies one of the option components can be an OTC option guaranteed or endorsed by the firm maintaining the proprietary position or carrying the customer account. Hedge transactions and positions established pursuant to these strategies are subject to a position limit equal to five times the standards limit established under Commentary .07 to Amex Rule 904. For purposes of this rule filing, an OTC option contract is defined as an option that is not listed on a National Securities Exchange or cleared at the Options Clearing Corporation.

¹¹ *Id.*

¹² *Id.*

¹³ Hedge transactions and positions established pursuant to this strategy are subject to a position limit equal to five times the standards limit established under Commentary .07 to Amex Rule 904.

option position and corresponding OTC option position must be within one strike price interval of each other and no more than one expiration month apart.

For reverse conversion, conversion and collar strategies, one of the option components can be an OTC option¹⁴ guaranteed or endorsed by the firm maintaining the proprietary position or carrying the customer account.

Within the list of proposed hedge strategies eligible for the Equity Hedge Exemption, the Exchange proposes that the option component of a reversal, a conversion or a collar position can be treated as one contract rather than as two (2) contracts. All three strategies serve to hedge a related stock portfolio. Because these strategies require the contemporaneous¹⁵ purchase/sale of both a call and put component, against the appropriate number of shares underlying the option (generally 100 shares) the Exchange believes that the position should be treated as one contract for hedging purposes.

With the exception of covered stock positions, Amex believes that all other proposed qualified strategies are market neutral,¹⁶ that none of the proposed strategies lend themselves to market manipulation and, they therefore, should qualify for the Equity Hedge Exemption. In addition, the Exchange believes that the current reporting requirements under Amex Rule 906 and internal surveillance procedures for hedged positions will enable the Exchange to closely monitor sizable option positions and corresponding hedges.

Under the proposed rule change, the standard position and exercise limits will remain in place for unhedged equity option positions. Once an account nears or reaches the standard limit, positions identified as a qualified hedge strategy will be exempted from position limit calculations. The exemption will be automatic (*i.e.* does not require pre-approval from the Exchange) to the extent that the member identifies that a pre-existing qualified hedge strategy is in place or is employed from the point that an account's position reaches the standard limit and provides the required supporting documentation to the Exchange.

¹⁴ For the purpose of this ruling, an OTC option contract is defined as an option that is not listed on a national securities exchange or cleared at the Options Clearing Corporation.

¹⁵ At or about the same time.

¹⁶ Where covered stock transactions are not market neutral (*i.e.* long stock/short call; short stock/short put); the market exposure on such activity resides with the stock position where no limit is imposed. As the short option premium serves no mitigate the stock exposure, no limit should be imposed on this strategy.

The exemption will remain in effect to the extent that the exempt positions remains intact and the Exchange is provided with any required supporting documentation. Procedures to demonstrate that the option position remains qualified are similar to those currently in place. Exchange procedures currently require a qualified account to report to the Exchange's Department of Market Surveillance all hedged positions together with the underlying stock positions that qualify the options position for the exemption. This report is filed with the Exchange no later than the close of business on the next day following the day on which the transaction or transactions that require the filing of such report occurred. Hedge information for member firm and customer accounts having 200 or more contracts are electronically reported via the Large Options Positions Report. Specialist and registered options trader account information is also reported to the Amex by such member's clearing firm. The existing requirement imposed on a member firms to report hedge information for proprietary and customer accounts that maintain an options position in excess of 10,000 contracts will continue to apply.

The Amex believes that, with the exception of covered stock positions, all of the proposed qualified hedge strategies are market neutral. Therefore, none of the proposed strategies lend themselves to market manipulation and should be exempt from position limits. In addition, the Exchange believes that the current reporting requirements under Amex Rule 906 and the surveillance procedures for hedged positions will enable the Exchange to closely monitor sizable option positions and corresponding hedges.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with section 6(b) of the Act¹⁷ in general and furthers the objectives of Section 6(b)(5)¹⁸ in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, to protect investors and the public interest and is not designed to permit unfair

discrimination between customers, issuers, brokers, or dealers.

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.

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

The Amex has neither solicited nor received written comments with respect to the proposed rule change.

III. 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 Section. Copies of such filing will also be available for inspection and copying at the principal office of Amex. All submissions should refer File No. SR-Amex-2001-72 and should be submitted by April 23, 2002.

IV. Commission Findings and Order Granting Accelerated Approval of Proposed Rule Change

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. In particular, the Commission believes the proposal is consistent with the requirements of section 6(b)(5) of the Act¹⁹ in that it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities,

¹⁹ 15 U.S.C. 78f(b)(5). In approving this rule change, the Commission notes that it has considered the proposal's impact on efficiency, competition, and capital formation, considered with section 3 of the Act. *Id.* at 78c(f).

¹⁷ 15 U.S.C. 78f(b).

¹⁸ 15 U.S.C. 78f(b)(5).

and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

Position and exercise limits serve as a regulatory tool designed to address potential manipulative schemes and adverse market impact surrounding the use of options. In general, the Commission has taken a gradual, evolutionary approach toward expansion of position and exercise limits. The Commission has been careful to balance two competing concerns when considering the appropriate level at which to set position and exercise limits. The Commission has recognized that the limits must be sufficient to prevent investors from disrupting the market in the component securities comprising the indexes. At the same time, the Commission has determined that limits must not be established at levels that are so low as to discourage participation in the options market by institutions and other investors with substantial hedging needs or to prevent specialists and market makers from adequately meeting their obligations to maintain a fair and orderly market.²⁰

The Commission has carefully considered the Amex's proposal to expand the hedge exemption from position and exercise limits. Given the market neutral characteristic of all the proposed qualified hedge strategies (except covered stock positions), the Commission believes it is permissible to expand the current equity hedge exemption without risk of disruption to the options or underlying cash markets. Specifically, the Commission believes that existing position and exercise limits, procedures for maintaining the exemption, and the reporting requirements imposed by the Exchange will help protect against potential manipulation. The Commission notes that the existing standard position and exercise limits will remain in place for unhedged equity option positions. To further ensure against market disruption, the Amex will establish a position and exercise limit equal to no greater than five times the standard limit for those hedge strategies that include an OTC option component.

Once an account nears or reaches the standard limit, positions identified as one or more of the proposed qualified hedge strategies will be exempted from limit calculations. Although the exemption will be automatic (*i.e.*, does not require pre-approval from the Exchange), the exemption will remain in effect only to the extent that the

exempted position remains intact and that the Exchange is provided with any required supporting documentation.

In addition, as described above, a qualified account must report hedge information each time the option position changes. Hedge information for member firm and customer accounts having 200 or more contracts are reported to the Exchange electronically, via the Large Options Position Report. Specialist and registered options trader account information is also reported to the Exchange electronically by the member's clearing firm. For those option positions that do not change, a filing is generally required on a weekly basis. Finally, the existing requirement imposed on member firms to report hedge information for proprietary and customer accounts that maintain an options position in excess of 10,000 contracts will remain in place.

The Commission believes these reporting requirements will help the Amex to monitor options positions and ensure that only qualified hedges are being exempt from position and exercise limits. To the extent that any position raises concerns, the Commission believes that the Amex, through its monitoring, will be promptly notified, and the Commission would expect the Amex to take any appropriate action, as permitted by its rules.

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of the notice of filing thereof in the **Federal Register**. The Commission notes that the proposal, as amended, is substantially identical to a proposed rule change submitted by the CBOE, which the Commission has approved.²¹ The Commission does not believe that the proposed rule changes raises novel regulatory issues that were not already addressed and should benefit Exchange members by permitting them greater flexibility in using hedge strategies advantageously, while providing an adequate level of protection against the opportunity for manipulation of these securities and disruption in the underlying market. Accordingly, the Commission finds that there is good cause, consistent with section 6(b)(5) of the Act,²² to approve the proposal, as amended, on an accelerated basis.

It is therefore ordered, pursuant to section 19(b)(2) of the Act,²³ that the proposed rule change (SR-Amex-2001-

72), as amended, is hereby approved on an accelerated basis.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.²⁴

Margaret H. McFarland,
Deputy Secretary.

[FR Doc. 02-7870 Filed 4-1-02; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45649; File No. SR-BSE-2002-03]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Boston Stock Exchange, Inc. To Extend Its Specialist Performance Evaluation Program

March 26, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934¹ notice is hereby given that on March 20, 2002, the Boston Stock Exchange ("BSE" 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 extend its Specialist Performance Evaluation Program until June 30, 2002. The proposed language is below. Added language is in *italics*. Deleted language is in *brackets*.

Chapter XV

Specialists

Specialist Performance Evaluation Program

Sec. 17 (a)–(e) no change.

(f) This program will expire on [March 31, 2002] *June 30, 2002*, unless further action is taken by the Exchange.

* * * * *

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

²¹ See Securities Exchange Act Release No. 44503 (March 20, 2002) (SR-CBOE-00-12).

²² 15 U.S.C. 78f(b)(5).

²³ 15 U.S.C. 78s(b)(2).

²⁴ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

²⁰ *Id.*