forth minimum standards for such programs. The standards established by the proposed rule change are substantially equivalent to those found in the existing bank anti-money laundering program rules.[7] Consistent with the USA PATRIOT Act, the proposed rule change would require firms to develop and implement a written anti-money laundering compliance program by April 24, 2002. The program would need to be approved in writing by a member of senior management and be reasonably designed to achieve and monitor the member's ongoing compliance with the requirements of the BSA and the implementing regulations promulgated thereunder. The proposed rule change would require firms, at a minimum, to (1) establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of suspicious transactions, (2) establish and implement policies, procedures, and internal controls reasonably designed to assure compliance with the BSA and implementing regulations, (3) provide for independent testing for compliance to be conducted by member personnel or by a qualified outside party, (4) designate an individual or individuals responsible for implementing and monitoring the day-to-day operations and internal controls of the program, and (5) provide ongoing training for appropriate personnel.

Prior to implementation of the proposed rule change, NASD Regulation anticipates providing guidance in a *Notice to Members* to assist member firms in developing an anti-money laundering program that fits their business model and needs.[8]

2. Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of section 15A(b)(6) of the Act,[9] which requires among other things, that the Association's rules must be 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. NASD Regulation believes that the proposed rule change is designed to accomplish these ends by establishing the minimum requirements for anti-money laundering compliance programs of member firms. These programs are designed to help identify and prevent money laundering abuses that can affect the integrity of the U.S. capital markets.

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

NASD Regulation does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

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

Written comments 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 NASD 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 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 NASD. All submissions should refer to file number SR-NASD–2002–24 and should be submitted by March 18, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[10]

Margaret H. McFarland,

Deputy Secretary.

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[7] *See e.g.,* 12 CFR 208.63.

[8] On February 12, 2002, the Securities Industry Association Anti-Money Laundering Committee released a *Preliminary Guidance for Deterring Money Laundering Activity*. In general, the guidance discusses key elements for a broker-dealer to consider in developing an effective anti-money laundering program.

[9] 15 U.S.C. 78o–3(b)(6).

[10] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–45454; File No. SR–NYSE–2001–43]

Self-Regulatory Organizations; Order Approving a Proposed Rule Change 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

February 15, 2002.

I. Introduction

On August 21, 2001, the New York Stock Exchange, Inc. (''NYSE'' 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 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 NYSE specialist is registered as such on the Exchange (''specialty stock''), provided that the requirements of the NYSE Rule 98 exemption program are met. The Exchange filed Amendment No. 1 to the proposed rule change on December 4, 2001.[3] The proposed rule change, as amended by Amendment No. 1, was published for comment in the **Federal Register** on December 12, 2001.[4] The Commission received two comment letters on the proposed rule change.[5] This order

[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'').

[4] *See* Securities Exchange Act Release No. 45136 (December 6, 2001), 66 FR 64328.

[5] *See* letters to Jonathan G. Katz, Secretary, Commission, from Edward J. Joyce, President and Chief Operating Officer, Chicago Board of Options Exchange, Inc. (''CBOE''), dated January 17, 2002

Continued

approves the proposed rule change, as amended.

II. Description of the Proposal

Currently, NYSE Rule 105 provides that an ''approved person'' (*i.e.,* an affiliate in a control relationship) of a NYSE specialist organization may trade options based on a specialty stock only for hedging purposes. If the approved person establishes a system of internal controls and information barriers pursuant to NYSE Rule 98, however, the approved person may engage in proprietary trading of options based on the specialist's specialty stock without being restricted solely to hedging transactions. In addition, pursuant to Guideline (1) to NYSE Rule 105, approved persons of NYSE specialists may act as competitive or non-primary market makers in options based on a specialty stock if NYSE-approved Rule 98 information barriers have been established. An approved person of a specialist may not, however, act as a specialist or primary market maker with respect to an option based on a specialty stock.

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 based on a specialty stock, provided that NYSE Rule 98 information barriers are established and approved by the Exchange.

III. Summary of Comments

The Commission received two comment letters on the proposed rule change.[6] Both commenters, CBOE and Knight, support the general objective of the proposed rule change, but disagree on whether an approved person's ability to act in a market making capacity with regards to options based on a specialty stock should be predicated on establishing Exchange-approved internal controls and information barriers under NYSE Rule 98.

CBOE supports the proposed rule change because it could: (1) enable CBOE's designated primary market makers (''DPMs'') to acquire more capital through combinations with broker-dealers that own NYSE specialists firms; and (2) enable NYSE specialists to become better capitalized through combinations with firms containing large options specialist firms. CBOE predicates its support for the proposed rule change upon the ''strict separation'' between the options specialist firm and the NYSE specialist firm. CBOE believes that this strict separation between the options specialist firm and the NYSE specialist firm should prevent side-by-side trading[7] in a stock and its overlying option.

Knight generally supports the proposed rule change and agrees with NYSE that ''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.'' However, Knight does not believe that (1) information barriers between the NYSE specialist and its approved person regarding trading and position information; (2) the separation of each entity's daily business activities with its own staff; and (3) trade decisions independent of the other entity should be preconditions for an approved person to act in a primary market maker capacity on options based on the specialist's specialty stock. Instead, Knight believes that communication between separate but affiliated business units engaged in both stock and option market making would grant a firm the ability to better risk manage its inventory and thus enable the firms to make deeper and more liquid markets. Further, Knight believes that the NYSE and the five national options exchanges are equipped with the necessary regulatory processes to monitor for any potential wrongdoing that could result from an entity's market making in a stock and its option.

IV. 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.[8] In particular, the Commission believes that the proposed rule change is consistent with Section 6(b)(5) of the Act,[9] 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.

Last year, the Commission approved an NYSE proposal to permit NYSE specialists to act as competitive or non-primary market makers in options based on the NYSE specialist's specialty stock so long as NYSE Rule 98 information barriers were established and approved.[10] In that order, the Commission noted the regulatory concerns that arise with integrated market making. Specifically, the Commission noted that integrated market making raises the concern that an integrated entity could unfairly use non-public market information to its advantage, or that an integrated entity could easily engage in improper conduct, such as manipulating the price of either the stock or the option to create unfair advantages that would be hard, if not impossible, to surveil.[11] Further, the Commission noted concerns about the potential conflicts of interest that may arise when an integrated entity has an obligation to make markets in both an option and its underlying equity. Finally, the Commission noted its concern about an exchange's ability to effectively surveil the trading practices of integrated entities.

When considering an integration proposal, the Commission must balance the potential improvements in the quality of the markets for the stocks and their related options against the competitive, regulatory, and surveillance concerns.[12] In this regard, the Commission must consider whether an integrated market making proposal would permit the integrated entities to possess undetectable, material non-public market information, which could give either the stock specialist or the related options specialist or market maker a trading advantage over other market participants. Thus, the Commission must evaluate the extent of the proposed integration, as well as the characteristics of the market center putting forth the proposal.

In the present proposed rule change, the Exchange seeks to permit its

(''CBOE Letter''); and Mathew D. Wayne, Chief Legal Officer, Knight Financial Products LLC (''Knight''), dated December 21, 2001 (''Knight Letter'').

[6] *Id.*

[7] The Commission notes that side-by-side trading generally refers to the practice of trading an equity security and its related option at the same physical location. The proposed rule change also implicates the practice of integrated market making, which refers to the practice of the same person or firm making markets in an equity security and its related options.

[8] 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).

[9] 15 U.S.C. 78f(b)(5).

[10] Securities Exchange Act Release No. 44175 (April 11, 2001), 66 FR 19825 (April 17, 2001).

[11] Previously, Commission staff has noted that substantial profits could be made from options positions as a result of small movements in the price of the underlying stock. Further, the staff has noted the relative ease by which the price of the underlying security could be moved and the difficulty in detecting improprieties associated with small price movements. SEC, Report of the Special Study of the Options Markets, H.R. Rep. No. IFC 3, 96th Cong. 1st sess. (Comm. Print 1978) (''Options Study'').

[12] See Options Study, *supra* note 11. *See also* Securities Exchange Act Release No. 22026 (May 8, 1985), 50 FR 20310 (May 15, 1985).

specialists to be affiliated with specialists and market makers that act as such with regards to options based on the NYSE specialist's specialty stock. The NYSE's proposal seeks to permit a more extensive form of integrated market making. The NYSE, however, seeks to limit the concerns raised by integrated market making by requiring the affiliated entities to establish strict information barriers designed to prevent the flow of non-public information. These information barriers must be approved by the NYSE and are subject to annual review by the NYSE.

Specifically, the related entities must organize their respective operations in such a way that the activities of each entity are clearly separate and distinct. The Guidelines to Exchange Rule 98 set forth the requirements to be followed by the related entities to be considered clearly separate and distinct. For example, Guideline (b)(i) requires organizational separation of the specialist and approved person and that the specialist must function as an entirely freestanding entity responsible for its own trading decisions. Guideline (b)(ii) requires the respective management structures of the specialist and the approved person to be organized in such a manner as to prevent the management of the approved person from exerting any influence on particular trading decision of the specialist. Guidelines (b)(iii) and (b)(iv) require the establishment of procedures to preserve confidentiality of trading information. In addition, Guideline (b)(iii) specifically requires the establishment of procedures to ensure the confidentiality of the specialist's book. Finally, the Guidelines require that the specialist and approved person maintain, among other things, separate books and records, financial accounting and capital requirements.

The Commission believes that the Exchange has established appropriate procedures in the Guidelines to address the regulatory issues raised by the proposed rule change. The requirement of clearly separate and distinct organizations, along with the other informational barriers and restrictions, should prevent Exchange specialists and their related options market makers from sharing restricted, non-public market information. Further, NYSE Rule 98 requires the Exchange to review and approve the organizational structure and information barriers of the integrated entities. The Commission notes that the Exchange has had extensive experience reviewing its Rule 98's organizational requirements and information barriers and thus should be able to ensure that the integrated entities do not improperly use their affiliations to their advantage. In addition, the Exchange has verified that organizational separation and information barriers must be established and maintained between an Exchange specialist, any approved person of the specialist that acts as a market maker in an option based on the specialist's specialty stock, and any other persons affiliated with them.[13]

The Commission continues to expect the Exchange to assess, as it gains experience with integrated market making, whether any other informational barriers are necessary to prevent the flow of market information between the related entities. Of course, any new information barriers proposed would have to be submitted to the Commission for approval. The Commission also expects that the Exchange will continue to surveil the integrated entities to ensure that the information barriers and organizational structure continue to prevent the flow of non-public market information.

In the previous order, the Commission noted that because the NYSE is the primary market for many equity securities underlying options, concerns were raised about an integrated organization being able to dominate the markets of both the specialty stock and its related options. Specifically, an integrated entity may by virtue of its positions as specialists in a stock and its related options could control the pricing and liquidity of both markets. The Commission believes the requirement that the related entities maintain complete organizational separation and prohibit the sharing of market information should prevent either entity from using its affiliation to control the pricing and liquidity of either market.

The Commission believes that the proposal should provide benefits to the markets. For example, the number of entities that may act as specialists or primary market makers in options based on a specialist's specialty stock may increase as a result of this proposal. Now, entities that have been prohibited from acting as primary options market makers because of the restrictions in Paragraph (1) of NYSE Rule 105 would be permitted to act in this capacity. This could lead to increased competition and liquidity in the options market.

In conclusion, the Commission believes that the Exchange has sufficiently minimized the potential for manipulative and improper trading conduct by requiring strict organizational separation and information barriers. Therefore, the Commission believes that the potential improvements to liquidity and quality of the markets outweigh the potential regulatory concerns.

For these reasons, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act.[14]

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,[15] that the proposed rule change (SR–NYSE–2001–43), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[16]

Margaret H. McFarland,

Deputy Secretary.

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[13] A specialist may be associated with more than one approved person. For example, a specialist may be controlled by a parent organization, which may also control other organizations. If any other organization controlled by the parent acts as a specialist or engages in market making activities in options based on the specialist's specialty stock, organizational separation and information barriers would have to be established between all entities, *i.e.,* the specialist, the parent company and the related options market making entities. *See* Securities Exchange Act Release No. 44175 (April 11, 2001), 66 FR 19825, 19827, n. 14 (April 17, 2001).

[14] 15 U.S.C. 78f(b)(5).

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

[16] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 35–27492]

Filings Under the Public Utility Holding Company Act of 1935, as Amended (''Act'')

February 15, 2002.

Notice is hereby given that the following filing(s) has/have been made with the Commission pursuant to provisions of the Act and rules promulgated under the Act. All interested persons are referred to the application(s) and/or declaration(s) for complete statements of the proposed transaction(s) summarized below. The application(s) and/or declaration(s) and any amendment(s) is/are available for public inspection through the Commission's Branch of Public Reference.

Interested persons wishing to comment or request a hearing on the application(s) and/or declaration(s) should submit their views in writing by