



THE CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

January 31, 2002

The Honorable John D. Dingell
Ranking Minority Member
Committee on Energy and Commerce
U.S. House of Representatives
2322 Rayburn House Office Building
Washington, DC 20515-6115

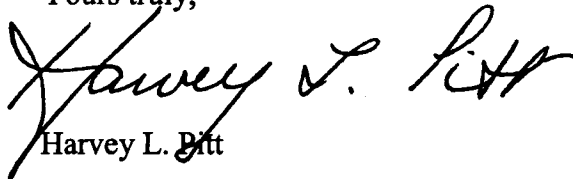
Dear Congressman Dingell:

This letter is in response to your December 18th letter concerning the General Accounting Office's report entitled Securities Regulation: Improvements Needed in the Amex Listing Program (GAO-02-18). At your request, the GAO examined the American Stock Exchange's listing program. In its report, the GAO recommended that the Commission direct Amex to: (1) implement mandatory quantitative listing requirements or provide ongoing public disclosure of noncompliant companies; and (2) report quarterly to its Board of Governors on the operating results of its equity listing program and make these reports available to the Commission for review.

We are pleased that Amex, as indicated in its response to the GAO's report, is working to make changes to its listing program that address the findings and recommendations outlined in the GAO's report. We fully support these enhancements to Amex's listing program, and we are committed to working with Amex to ensure that these improvements are implemented promptly and effectively to best protect investors. Amex recently filed with the Commission a proposed rule change that would implement mandatory quantitative listing requirements and impose definitive time limits with respect to how long a non-compliant company can retain its listing. We are reviewing this proposed rule change and will seek to ensure that the changes adequately address the GAO's findings and recommendations. Amex has also agreed to prepare quarterly management reports that will describe the overall effectiveness of the Amex equity listing program. We will request and review copies of these reports on an ongoing basis, and seek to ensure they contain sufficient information to demonstrate the overall effectiveness of Amex's initial and continued listing programs.

Please contact me at (202) 942-0100 or Lori A. Richards, Director of the Office of Compliance Inspections and Examinations, at (202) 942-7400 if you have any questions or need additional information.

Yours truly,


Harvey L. Pitt

The Honorable John D. Dingell

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cc: The Honorable W.J. (Billy) Tauzin
The Honorable Michael G. Oxley
The Honorable John J. LaFalce
The Honorable Richard H. Baker
The Honorable Paul E. Kanjorski
The Honorable David M. Walker
Mr. Salvatore F. Sodano



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2322 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Dingell:

Thank you for your December 19th letter to Attorney General Ashcroft and me following up on the April 1999 *Business Week* article regarding various alleged regulatory problems at the American Stock Exchange. We appreciate your interest in this important subject, and I want to assure you that we take any suggestions of regulatory problems seriously and try to respond to them promptly.

Changes in the options markets since the *Business Week* article have enhanced the quality of competition and regulation in those markets. On September 11, 2000, the Commission instituted and simultaneously settled an administrative proceeding against the Amex, the Chicago Board Options Exchange, the Philadelphia Stock Exchange, and the Pacific Exchange finding, among other things, insufficient regulatory programs related to on-floor order handling. Pursuant to the order, a copy of which is enclosed, the Amex and these other options exchanges agreed to enhance their regulatory programs for on-floor order handling violations.¹ In addition, with the advent of multiple listings in August 1999, the options markets now compete vigorously for order flow. Moreover, the Amex has finalized enforcement actions imposing sanctions against those identified in the *Business Week* article responsible for engaging, or supervising those that had engaged, in illegal floor trading. Each of these developments is discussed in more detail below.

Commission Administrative Proceeding and Staff Inspections

As part of the Commission's oversight of self-regulatory organizations, our staff conducted an inspection of the surveillance, investigative, and enforcement programs of the Amex related to order handling practices in July 1999. The staff also conducted similar inspections of the CBOE, Phlx, and PCX. The deficiencies our staff found during these inspections were among the matters addressed by the Commission's September 11, 2000 order.

¹ Consistent with the Commission's practice, the settling respondents did not admit or deny the Commission's findings.

In its order, the Commission found that the Amex and the other three options exchanges had followed a course of conduct under which they refrained from multiply listing a large number of options and inadequately discharged their obligations as self-regulatory organizations. Specifically, the Commission found that the exchanges failed to adequately enforce compliance with their rules, including order handling rules, as well as rules prohibiting anti-competitive conduct, such as harassment, intimidation, refusals to deal, and retaliation directed at market participants who sought to act competitively. In addition, the Commission found that the options exchanges failed to enforce compliance with their trade reporting rules, which promote transparency of the market and facilitate surveillance and enforcement of other exchange rules and the federal securities laws.

In settling the Commission's administrative proceeding, the Amex and the other three options exchanges agreed to, among other things, promptly enhance their surveillance, investigative, and enforcement programs with respect to options order handling rules, including the duty of best execution, limit order display rules, priority rules, trade reporting, and firm quote rules. In addition, the exchanges each agreed to adopt or amend rules concerning their automated quotation and execution systems, which substantially enhance incentives to quote competitively and substantially reduce disincentives for market participants to act competitively. Moreover, the exchanges agreed to adopt sanctioning guidelines that are reasonably designed to effectively enforce compliance with such exchanges' options order handling rules.

The Commission staff continues to monitor these four options exchanges' compliance with the order. Thus far, the Amex has implemented some automated systems to surveil for order handling violations. In addition, the Amex has increased its regulatory staff and filed rule changes to implement a 90-second trade-reporting requirement and to modify its sanctioning guidelines for violations of order handling rules. The Amex also began conducting on-floor surveillance for anti-competitive conduct and order handling violations.

Multiple Listing

Historically, the options exchanges maintained allocation rules that imposed limitations on the exchanges' ability to multiply list each other's options classes. In 1989, the Commission adopted Rule 19c-5, which banned these limitations. As found by the Commission in its September 11, 2000 order, however, the exchanges continued to engage in a course of conduct since 1989 to refrain from multiply listing each other's options classes. On the same day as the Commission's order, the Department of Justice filed a civil antitrust action against the exchanges, charging that they had illegally agreed that they would not list equity option classes listed already on one of the other exchanges. At the same time, the Justice Department filed a consent decree that resolved the lawsuit. In response to the investigations by the Justice Department and the Commission, the exchanges began to multiply list each other's actively traded classes in August 1999, and now aggressively compete with each other for order flow in all actively traded options classes and nearly all less active options classes.

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Specific Cases of Illegal Floor Trading

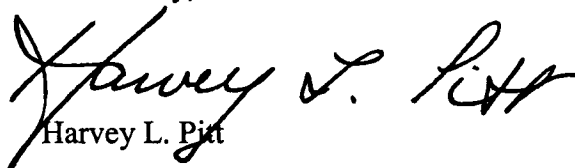
In addition, over the last two and a half years, the Amex completed enforcement proceedings and imposed sanctions against Pasquale Schettino, Joseph Giamanco, and Spear, Leeds & Kellogg. On June 1, 1999, the Amex fined Schettino \$100,000 and permanently barred him from the exchange. On December 5, 2000, Giamanco consented to a censure, a \$150,000 fine, and a permanent bar from the exchange. Additionally, on November 26, 2001, pursuant to a settlement, the Amex fined Spear, Leeds & Kellogg \$1 million for failing to supervise Schettino, the largest fine the Amex had ever imposed.

Finally, *Business Week* alleged that Giamanco, as well as other Amex specialists, had received cheap private placement stock in companies that later obtained Amex listings and to which those specialists were then assigned. Commission staff recently conducted inspections of the Amex's listings and allocation processes, and reviewed issues related to a specialist's ownership of private placement stock in companies seeking an Amex listing. The staff found no evidence that specialists' ownership of private placement stock improperly impacted the listing or allocation process.

* * *

Although developments, including multiple listings and the Commission's enforcement action, have enhanced competition and regulation in the options markets in the two and a half years since the *Business Week* article, let me assure you that the Commission continues to diligently monitor the regulatory programs at each of the options exchanges.

Yours truly,


Harvey L. Pitt

Enclosure

cc: The Honorable W.J. "Billy" Tauzin
The Honorable Michael G. Oxley
The Honorable John J. LaFalce
The Honorable Richard H. Baker
The Honorable Paul E. Kanjorski
The Honorable John Ashcroft